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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1960.

No. 242

STANDARD ASBESTOS MANUFACTURING AND INSULATING COMPANY, INC., and
GEORGE M. RYDER, EXECUTOR OF THE ESTATE OF ALICE D. RYDER, DECEASED,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

WALTER A. RAYMOND and
KENNETH C. WEST,
1313 Home Savings Building,
Kansas City, Missouri,
Counsel for Petitioners.

HARRY H. ELLIS,
920 Argyle Building,
Kansas City, Missouri,
of Counsel.

E. L. MENDENHALL, INC., 1108 Oak Street, Kansas City 6, Mo., HArrison 1-3030

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SUPREME COURT OF THE UNITED STATES

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STANDARD ASBESTOS MANUFACTURING AND INSULATING COMPANY, INC., and

GEORGE M. RYDER, EXECUTOR OF THE ESTATE OF ALICE D. RYDER, DECEASED,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

TO THE HONORABLE, THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioners, Standard Asbestos Manufacturing and Insulating Company, Inc., and George M. Ryder, Executor of the Estate of Alice D. Ryder, Deceased, pray that a writ of certiorari issue to the United States Court of Appeals for the Eighth Circuit, which Court, on petitions to review two decisions of the Tax Court, affirmed the decisions of the Tax Court thereby sustaining the respondent in holding petitioners liable for additional federal income tax for the

years 1949, 1950, 1951 and 1952, in cases consolidated and tried together in the Tax Court and in the Court of Appeals.

In the first case petitioner Standard Asbestos Manufacturing and Insulating Company was held liable by the Tax Court of the United States for deficiencies in payment of income taxes for the calendar years 1949, 1950 and 1951 (involving issues of officers' salaries), in the respective amounts of $11,094.67, $28,799.31, and $39,662.60.

In the second case the petitioner, George M. Ryder, Executor of the Estate of Alice D. Ryder, Deceased, was held liable by the Tax Court of the United States for deficiencies in income tax payments for the calendar years 1950 and 1952 (involving issues of payment to the widow of a deceased officer), in the respective amounts of $3,710.03 and $4,558.74.

OPINIONS BELOW.

The memo opinion of the Tax Court of the United States in the consolidated cases is not officially published but is designated as "T.C. Memo 1958-42." Such opinion of the Tax Court is found in Prentice Hall Tax Court Memo, paragraph 58,042, is printed in the Record in the Court of Appeals at pages 58 to 88, and appears in the appendix at the end of this petition as Exhibit A.

The opinion of the United States Court of Appeals for the Eighth Circuit is reported in F.2d , and is also printed in the record following page 360, and appears in the appendix to this Petition as Exhibit B.

The joint petition for rehearing of Petitioners appears in the appendix to this Petition as Exhibit C.

The judgment of the United States Court of Appeals to be reviewed was entered on April 4, 1960, and Peti-

tioners' joint motion for rehearing or for transfer to the Court *en Banc* was overruled on April 29, 1960, and appears in the appendix to this Petition as Exhibit D.

The judgments of the Court of Appeals in said cases appear in the Appendix as Exhibits E and F.

JURISDICTION.

The jurisdiction of this Court is invoked under United States Code, Title 28, Section 1254 (1) and Section 7482 of the Internal Revenue Code.

The Tax Court acquired jurisdiction upon petition of Petitioners for redetermination of the deficiencies assessed against them by the Commissioner of Internal Revenue. 26 U.S.C. 1939, Sec. 272.

QUESTIONS PRESENTED.

1. Did the issue of whether any portion of the salaries paid W. D. Ryder, R. E. Ryder and G. M. Ryder by petitioner, Standard Asbestos and Insulating Company, Inc., for the years in question (1949, 1950, 1951) were intended as payment for services rendered in prior years present a question of fact only for the determination of the Tax Court or did it present a conclusion of law, or, at least, a determination of a mixed question of law and fact?

2. Was the issue of whether the questioned salary payments were intended as payment for services in prior years subject to judicial review of a character which authorized the Court of Appeals to substitute its judgment for that of the Tax Court if the record so warranted, or was it limited to reversal only in the event the Tax Court ruling was found to be "clearly erroneous"?

3. Did the issue of whether the sums paid Alice D. Ryder, widow of Willard E. Ryder, by Standard Asbestos Manufacturing and Insulating Company, Inc., for the years in question (1950 and 1952) were dividends or a pension present a question of fact only for the determination of the Tax Court or did it present a conclusion of law, or, at least, a determination of a mixed question of law or fact?

4. Was the issue of whether the questioned payments to the widow of Willard E. Ryder were dividends or as a pension subject to judicial review of a character which authorized the Court of Appeals to substitute its judgment for that of the Tax Court if the record so warranted, or was it limited to reversal only in the event the Tax Court ruling was found to be "clearly erroneous"?

5. Did the ruling of the Court of Appeals restricting the scope of its review in both of the consolidated cases to determining whether the ruling of the Tax Court was "clearly erroneous" constitute an erroneous misinterpretation and misapplication of the applicable law and base its opinion herein on an erroneous view of the law?

6. Under *Bogardus* v. *Commissioner of Internal Revenue*, 302 U.S. 34, 38-39, 58 S. Ct. 61, 64; *Helvering* v. *Tex-Penn Oil Company*, 300 U.S. 481, 491, 57 S. Ct. 569, 573, 574; and *Helvering* v. *Rankin*, 295 U.S. 123, 131, 55 S. Ct. 732, 736, are not the basic issues here involved conclusions of law, or, at least, determinations of mixed questions of law and fact as to which petitioners were entitled to a judicial review in the Court of Appeals with the Court of Appeals recognizing and feeling free to exercise its freedom of decision to substitute its judgment for that of the Tax Court if the record so warranted?

7. Are the findings of the Tax Court in the two cases essentially ones dealing with the effect of certain trans-

actions or events, rather than findings which resolved disputed facts?

Stevenot v. *Norberg*, 9 Cir., 210 F.2d 615, 619.

8. Is there need for a review by this Court of the issues here presented and an authoritative opinion of this Court resolving and settling the conflict between the opinion of the Court of Appeals herein limiting its review to the "clearly erroneous" test and the opinions of other Courts of Appeals such as those of the Fourth Circuit in *Bounds* v. *United States*, 262 F.2d 876, 880 (1); Seventh Circuit in *Jennings* v. *United States*, 7 Cir., 272 F.2d 842, 845 and *Ortmayer* v. *C. I. R.*, 7 Cir., 265 F.2d 848, 854 (8); Ninth Circuit in *Hypotheek Land Company* v. *Commissioner of Internal Revenue*, 9 Cir., 200 F.2d 390, 392 (1); Second Circuit in *Towner* v. *Commissioner of Internal Revenue*, 2 Cir., 182 F.2d 903, 905 (2); holding under similar facts the Reviewing Court should provide a full judicial review and feel free to substitute its own judgment for that of the Tax Court if the record so warranted?

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved are set out verbatim in the appendix, but the citations thereto are as follows:

26 U.S.C.A. 1939, Sec. 23 (a) (1) (A).
26 U.S.C. 1939, Sec. 22 (b) (3).
26 U.S.C. 1952, Sec. 115.
Regulations 111, Sec. 29.22(b)-1.
Regulations 111, Sec. 29.22(b) (3)-1.
Regulations 111, Sec. 29.23(a)-1.
Regulations 111, 29.23(a)-9.
Regulations 111, 29.22(a)-1.
Regulations also found in Title 26, Part 29, Code of Federal Regulations.

STATEMENT OF THE MATTER INVOLVED.

Petitioner Standard Asbestos Manufacturing and Insulating Company, Inc., is a Missouri Corporation with offices in Kansas City, Missouri. It was incorporated to do a general asbestos and insulating business and developed into a technical specialties contractor organization handling all or part of the specifying, fabricating, manufacture, cost estimating, erection and surface finishing in connection with highly technical construction work involving insulating, air conditioning and temperature control insulations. Its books were kept on an accrual basis for the calendar year.

The Ryder brothers, Willard D. Ryder, George M. Ryder and Richard E. Ryder, joined the Standard Company in 1918 soon after its organization by their father, Willard E. Ryder. They served the company continuously thereafter, except for short intervals. The wages each of the brothers received during the 1920's and 1930's were small, far below the standard for the industry. In the years 1919 to 1940, inclusive, the individual salaries of the brothers ranged from $910.00 to $3,797.00 per annum (R. 39).

From April 1, 1949, to date, Willard was president, George was vice-president and treasurer and Richard was secretary. The three performed the duties of the major offices of the corporation and estimated, bid, and supervised the work on contracts of over $5,000.00 and up to $800,000.00 (R. 234).

In December, 1937, the Board of Directors of Standard took action to pay additional compensation for the years 1928 to 1930, in an amount equal to 40% of the salaries actually paid. In January, 1941, the salaries of the Ryder Brothers were raised to $11,000.00 because of low salaries

paid them prior to 1937. In January, 1942, their salaries were raised to $20,000.00 because of low salaries prior to 1937.

The salaries of the Ryder Brothers were raised for the years 1949, 1950 and 1951, by resolutions which did not recite the raises were for compensation to make up for low salaries in prior years, although it is claimed such was the purpose.

The Commissioner of Internal Revenue determined the increased salaries were not payment for low salaries in previous years and assessed deficiencies in income taxes against Petitioner Standard Company for the calendar years 1949, 1950 and 1951. On appeal to the Tax Court of the United States, Petitioner Standard Company was held liable for deficiencies in federal income taxes for the calendar years 1949, 1950 and 1951, in the respective amounts of $11,094.67, $28,799.31, and $39,662.60.

Alice D. Ryder was the 84-year old widow of Willard E. Ryder, founder of Standard, and the owner of stock in the corporation. In the year 1950 Mrs Ryder, without rendering servces therefor, received $27,367.40, and in 1952 she received $32,645.09 from Standard, pursuant to authorization of the Board of Directors, which it is claimed was intended as a pension.

The Commissioner of Internal Revenue determined such payments were made under a written family stock control agreement as part of a plan to control the stock and therefore subject to tax and assessed deficiencies in income taxes against her for the years 1950 and 1952. Upon appeal to the Tax Court she was held liable for deficiencies in federal income taxes for the calendar years 1950 and 1952 in the respective amounts of $3,710.00 and $4,558.74, plus additional amounts as pen-

alties not now material. While the cases were pending on appeal in the Court of Appeals, Alice D. Ryder died and, upon suggestion of her death, George M. Ryder as executor of her estate was substituted as Petitioner.

The issues before the Tax Court were as follows (Court of Appeals Opinion, pp. 5, 6):

> "Petitioners, in seeking reversal, contend (1) the Tax Court erred in holding that none of the compensations paid by petitioner Standard Asbestos Manufacturing and Insulating Company, Inc., to Willard D. Ryder, George M. Ryder, and Richard E. Ryder for the years 1949, 1950 and 1951 was intended as compensation for services rendered in prior years; (2) the Tax Court erred in holding that the compensations paid by Standard to Willard D. Ryder, George M. Ryder, and Richard E. Ryder, for the services rendered by each of them for the year 1949, were unreasonable to the extent that they were in excess of $42,500.00 for each of them, and the Tax Court erred in holding that the compensations paid to them for the services rendered by each of them for the years 1950 and 1951, respectively, were unreasonable to the extent they were in excess of $47,500.00 for each of them for each of said years; (3) the Court erred in holding that amounts accrued and paid by Standard in 1949, 1950, and 1951, in the sums of $20,491.08, $32,645.08, and $32,645.09, respectively, to Mrs. Ryder were not deductible by Standard in any part as a pension; (4) The Tax Court erred in holding that the amounts received by Mrs. Ryder from Standard in 1950 and 1952, in the sums of $27,367.40 and $32,645.09, respectively, were distributions of profit and were includible in Mrs. Ryder's taxable income; and (5) the Tax Court erred in holding that Mrs. Ryder failed to meet the burden of proving reasonable cause for failure to file declaration of estimated tax for 1950, and erred in holding that additions to tax were applicable under the Internal Revenue Code of 1939, Sections 294 (d) (1) (A) and 294 (d) (2)."

The Court of Appeals affirmed the judgments of the Tax Court in both of the consolidated cases (except as to certain penalties assessed against the widow's estate) on the basis that the court was without jurisdiction to afford a judicial review and substitute its judgment for that of the Tax Court but was limited to determining only the question of whether the rulings of the Tax Court were clearly erroneous.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

1. The Decision of the Court of Appeals Is in Conflict with Applicable Decisions of This Court.

Conflict between the decision of a Court of Appeals and this Court is ground for issuance by this Court of its Writ of Certiorari. *Heflin* v. *United States*, 358 U.S. 415, 417, 79 S. Ct. 451, 452; *Pennsylvania R. Co.* v. *O'Rourke*, 344 U.S. 334, 336, 73 S. Ct. 302, 303. The question is important and recurring as hereinafter pointed out. *Glus* v. *Brooklyn Eastern Dist. Term.*, 359 U.S. 231, 232, 79 S. Ct. 760, 762. The Tax Court in the first case made a finding that no portion of the salaries paid its officers by Petitioner Standard Asbestos Manufacturing and Insulating Company, Inc., for the years 1949, 1950 and 1951 was intended as payment for services rendered in prior years but was taxable as current income for the years in question (Tr. 70, 79, Opinion p. 8). This finding was based almost, if not entirely, on the written minutes and records of the corporation (Tr. 61, 62-71, 77-81, 100-200). All the basic facts on each issue involved here were either agreed to or established by uncontradicted and unimpeached writings (Tr. 106-200). In determining this issue the Tax Court did

not pass on the credibility of any witness appearing before it. The stipulation of facts and exhibits thereto occupy 100 pages of the record of transcript (Tr. 100-200).

The Tax Court in the second case made a finding that the payments to the widow, Mrs. Ryder, represented a distribution of profits by the company and not as a pension or gratuity (Opinion p. 14, Tr. 85-87).

Likewise in the second case the finding was based almost, if not entirely, on the written minutes and records of the corporation and a written contract between the widow and the other members of the Ryder family (Opinion pp. 11-14, Tr. 73-77, 59-60, 61, 100-200). All the basic facts in the second case on the issues here involved were either agreed to or established by uncontradicted and unimpeached writings. In determining the issue the Tax Court did not pass on the credibility of any witness appearing before it (Opinion pp. 11-14, Tr. 73-77, 59-60, 100-200). Petitioners make no complaint against the findings of basic facts but rather the conclusions drawn therefrom.

The only contradiction in basic facts came, after the Tax Court had determined that the salaries paid such officers for the years involved were taxable as current income for such years, and it became necessary to determine whether the salaries paid were reasonable or not (Opinion pp. 8-11, Tr. 79-83). Witnesses for the respective parties testifying as to what were reasonable salaries for such officers for the years in question gave figures quite divergent (Opinion p. 10, Tr. 22, 226, 71-73, 81-82). The Tax Court accepted the figures of neither witness but made a finding of its own fixing the amounts allowed as reasonable in between the figures submitted by the experts for the parties (Opinion pp. 10, 4, 6, Tr. 73, 81-83). That issue, which we believe to be the only factual controversy in the cases, is not here involved.

The Court of Appeals ruled both cases as pure questions of fact as to which appellate jurisdiction was limited to determining whether the decisions of the Tax Court were "clearly erroneous." (Opinion pp. 8, 14, 15.)

It is Petitioners' position that the principal issues, other than the reasonableness of the salaries paid, were conclusions of law, or mixed questions of law and fact as to which it was the duty of the Court of Appeals to judicially review with authority and substitute its judgment for that of the Tax Court, if it did not agree with the Tax Court. The findings here are essentially ones dealing with the effect of certain transactions or events, rather than a finding which resolved disputed facts.

In limiting its review to determining whether the decisions of the Court of Appeals were "clearly erroneous" and denying Petitioners the right to a full judicial review we believe the Court of Appeals brought the opinion herein into conflict with the previous and controlling decision of this Court in the case of *Bogardus* v. *Commissioner of Internal Revenue*, 302 U.S. 34, 38-39, 58 S. Ct. 61, a certiorari proceeding involving the issue of whether a sum of money received by petitioner was taxable compensation or a gift, the Court said (l.c. 64):

> "The Board of Tax Appeals concluded that, from a careful consideration of all the evidence, 'the payments made by Unopco to the petitioners and others were additional compensation in consideration of services rendered to Universal and were not tax-free gifts.' This, as we recently have pointed out, is 'a conclusion of law or at least a determination of a mixed question of law and fact. It is to be distinguished from the findings of primary, evidentiary, or circumstantial facts. It is subject to judicial review and, on such review, the court may substitute its judgment for that of the Board.' Helvering v. Tex-Penn Oil Co., 300 U.S.

481, 491, 57 S. Ct. 569, 573, 574, 81 L. Ed. 755; Helvering v. Rankin, 295 U.S. 123, 131, 55 S. Ct. 732, 736, 79 L. Ed. 1343."

We believe the opinion of the Court of Appeals herein is likewise and for the same reason in conflict with the previous and controlling decision of this Court in the case of *Helvering* v. *Tex-Penn Oil Co.*, 300 U.S. 481, 491, 57 S. Ct. 569, an action by the commissioner to establish certain items as taxable income, the Court said (l.c. 574):

> "In addition to and presumably upon the basis of these findings, the Board made its 'ultimate finding.' And upon that determination it ruled that the transaction was not within the nonrecognition provisions of section 202 (b). The ultimate finding is a conclusion of law or at least a determination of a mixed question of law and fact. It is to be distinguished from the findings of primary, evidentiary, or circumstantial facts. It is subject to judicial review and, on such review, the court may substitute its judgment for that of the Board." Helvering v. Rankin, ubi supra."

The restricted review on appeal afforded Petitioners by the Court of Appeals is in obvious conflict with the principles applicable under the decisions of this Court cited above involves a question of jurisdiction and is a valid basis for the issuance of a Writ of Certiorari in this case. *Parsons* v. *Smith*, 359 U.S. 215, 216, 79 S. Ct. 656, 658.

Petitioners confidently assert that their assignments of error briefed and presented in the Court (Opinion pp. 5, 6) are meritorious and that they have reasonable grounds to believe and do believe that if they can obtain a full judicial review in the Court of Appeals with the Court of Appeals not limiting itself to determination of whether the decision of the Tax Court is "clearly erroneous" but acting under the duty and right to substitute its own judgment

for that of the Tax Court if it deems justice requires, such a hearing in a full judicial review will likely result in a reversal and remand of the Tax Court judgment.

As pointed out under Point 2, *infra*, this question is of a constantly recurring nature which is an especial reason why the writ should be granted. *Cammarano* v. *United States*, 358 U.S. 498, 500, 79 S. Ct. 524, 526.

2. The Decision of the Court of Appeals Herein Is in Conflict with the Decisions of Other Courts of Appeals As to the Scope of Appellate Jurisdiction and the Nature, Character and Scope of the Review Provided by Law in Appeals from the Tax Court.

A conflict of decisions between the circuits of the United States Courts of Appeals is ground for issuance of a Writ of Certiorari by this Court. *Commissioner of Internal Revenue* v. *Hansen*, 360 U.S. 446, 450, 79 S.Ct. 1270, 1272-1273; *Flora* v. *United States*, 357 U.S. 63, 64, 78 S. Ct. 1079, 1080-1081. The question here is important and recurring as hereinafter pointed out. *Glus* v. *Brooklyn Eastern Dist. Term.*, 359 U.S. 231, 232, 79 S.Ct. 760, 762. We have already pointed out under point 1 above that there is here no conflict in the essential and basic facts but rather in the conclusions drawn by the Tax Court from such facts.

It is our position that Petitioners received at the hands of the Court of Appeals only a restricted review limited to the mere determination of whether the decisions of the Tax Court were "clearly erroneous" when they were entitled under the law to a full judicial review with the Court of Appeals authorized and fully cognizant of its power and right to substitute its judgment for that of the Tax Court if the record warranted. The findings here are

essentially ones dealing with the effect of certain transactions or events, rather than a finding which resolved disputed facts. In holding petitioners to such limited review the opinion of the Court of Appeals deprived them of their legal rights and came into conflict with decisions on similar facts in other Circuits in the following cases.

In the case of *E. H. Sheldon & Co.* v. *Commissioner of Internal Revenue*, 6 Cir., 214 F.2d 655, in an appeal from the Tax Court, the Court of Appeals for the Sixth Circuit said (l.c. 658):

> "As a preliminary matter, we dispose of the Commissioner's contention that the finding of the Tax Court that such expenditures were not ordinary and necessary expenses of carrying on the business during the years in question but were capital expenditures is not clearly erroneous and is conclusive under Sec. 1141(a), Internal Revenue Code, 26 U.S.C.A., § 1141(a), and Rule 52(a), Rules of Civil Procedure, 28 U.S.C.A. The subsidiary facts in this case are uncontradicted, and such facts, so found by the Tax Court, are accepted by us under Rule 52(a). However, the findings of the Tax Court, which are now relied upon by the Commissioner, are conclusions drawn by the Tax Court from the uncontradicted subsidiary facts, the drawing of which did not involve any element of seeing or hearing the witnesses or of judging their credibility. As we have heretofore pointed out, under such circumstances this Court will make its own evaluation of the conclusions to be drawn from the facts established by the evidence. Letcher County v. De Foe, 6 Cir., 151 F.2d 987, 990; Seagrave Corp. v. Mount, 6 Cir., 212 F.2d 389. See Orvis v. Higgins, 2 Cir., 180 F.2d 537, 539.
>
> "In our opinion, the cases do not support the Tax Court's ruling."

Likewise here the conclusions drawn by the Tax Court did not involve seeing or hearing the witnesses or of judg-

ing their credibility and it was the duty of the Court of Appeals to make its own evaluation of the conclusions to be drawn from the facts.

In the case of *Thomas* v. *Commissioner of Internal Revenue*, 5 Cir., 254 F.2d 233, in a petition by a taxpayer for review of a decision of the Tax Court, the Court of Appeals for the Fifth Circuit said (l.c. 236):

> "In the case before us there is no basic disagreement as to the evidentiary facts. In such situation, as has been said on several occasions, if the conclusion of the trial court as to the ultimate fact is merely, as here, a product of legal reasoning, that conclusion is subject to appellate review free from the restraint of the clearly erroneous rule. Galena Oaks Corp. v. Scofield, 5 Cir., 1954, 218 F.2d 217; Goldberg v. Commissioner, 5 Cir., 1955, 223 F.2d 709; Consolidated Naval Stores Co. v. Fahs, supra; Smith v. Commissioner, supra; Fahs v. Taylor, 5 Cir., 1956, 239 F.2d 224; Gamble v. Commissioner, supra."

In the case of *Stevenot* v. *Norberg*, 9 Cir., 210 F.2d 615, in an action for reinstatement of an employee after discharge, the Court said (l.c. 619):

> "Appellees argue that we are bound by the foregoing findings, since the record does not show that they are clearly erroneous. We do not think so. When a finding is essentially one dealing with the effect of certain transactions or events, rather than a finding which resolves disputed facts, an appellate court is not bound by the rule that findings shall not be set aside, unless clearly erroneous, but is free to draw its own conclusions."

It is Petitioners' contention that the facts of this case fit the ruling in the above case thereby creating direct conflict of opinion.

In the case of *Gudgel* v. *Commissioner of Internal Revenue*, 6 Cir., 273 F.2d 206, in a petition to review a decision of the Tax Court, the Court of Appeals for the Sixth Circuit said (l.c. 209):

> "This brings us to a consideration of the scope of our power of review in tax litigation. By Title 26 U.S.C., § 7482, the United States Courts of Appeals were given exclusive jurisdiction to review decisions of the Tax Court '* * * in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury'. This is substantially an application of the old equity rule and is the subject matter of Rule 52(a) of the Federal Rules of Civil Procedure, 28 U.S.C., which recites that 'findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses'. There has been a difference of opinion as to whether the reason for the rule conditions its application. The courts have almost invariably, in applying the rule, cited the reason for its existence, and absent the reason; that is, where there is conflicting evidence, it requires a judgment as to the good faith, truthfulness and candor of witnesses. It is felt, however, in many cases, that the Court of Appeals is as well qualified as the District Judge, or the Tax Court, to draw inferences and conclusions from undisputed facts without subjecting them to the test of the 'clearly erroneous' rule."

(l.c. 210:)

> "In Yunker v. Commissioner, supra, we held that when the evidentiary facts are not in dispute the reviewing Court is not bound by findings of ultimate fact below.
>
> "We have examined many cases and have listed in the margin[1] illustrative cases on both sides of the question."

In footnote 1 on page 210 of 273 F.2d the Court lists in separate paragraphs the decisions of the various Courts of Appeals following the "clearly erroneous" rule and the decisions of the Courts of Appeals holding to the contrary. The second, third, sixth and ninth circuits are listed in such footnote as refusing to be bound by the "clearly erroneous" doctrine. Other circuits which might be added as opposing the "clearly erroneous" rule are:

The Seventh Circuit in *Jennings* v. *United States*, 7 Cir., 272 F.2d 842, 845; the Fourth Circuit in *Bounds* v. *United States*, 4 Cir., 262 F.2d 876, 880; and the Fifth Circuit in *Thomas* v. *Commissioner of Internal Revenue*, 5 Cir., 254 F.2d 233, 236, quoted above.

The above illustrates the recurring nature of this question and the importance to the proper administration of the Internal Revenue laws of a review by this Court and an authoritative and controlling decision resolving this conflict. *Camarano* v. *United States*, 358 U.S. 498, 500, 79 S. Ct. 524, 526.

The Court of Appeals ruled both cases as pure questions of fact as to which its appellate jurisdiction was limited to determining whether the decisions of the Tax Court were "clearly erroneous." (Opinion pp. 8, 14, 15).

The ruling that the issues were to be determined as pure questions of fact and that the Court of Appeals was limited on review to determination of whether the decisions were "clearly erroneous" are both in direct conflict with the decision and opinion of the United States Court of Appeals for the Fourth Circuit in the case of *Bounds* v. *United States*, 4 Cir., 262 F.2d 876, which was a suit for income tax refund of money paid by a corporation to the widow of a deceased executive involving the issue of whether such payments constituted a non-taxable gift or taxable com-

pensation. In holding the payments constituted a non-taxable gift to the taxpayer, the Court said (262 F.2d l.c. 880):

> "The District Court's determination that the payments were intended by the corporation to be and were compensation, having been drawn from stipulated primary facts, is a conclusion of law, or at least a determination of a mixed question of law and ultimate fact; and, as such, this court can, on review, substitute its judgment for that of the District Court as a matter of law if the record so warrants. We are not bound by the 'clearly erroneous' rule, Rule 52(a) of the Federal Rules of Civil Procedure, 28 U.S.C.A. Bogardus v. Commissioner, 1937, 302 U.S. 34, 39, 58 S. Ct. 61, 82 L. Ed. 32; Simpson v. United States, 7 Cir., 261 F.2d 497; Fahs v. Taylor, 5 Cir., 1956, 239 F.2d 224, 226; Northrup v. United States, 2 Cir., 1957, 240 F.2d 304, 307."

While the facts in these cases were not stipulated there is no substantial controversy as to the basic facts but only as to the conclusions properly to be drawn therefrom. The facts and issues in the Bounds case are strikingly similar to those in the second or Widow's case here involved, and the same reasoning is applicable to the first case involving officers' compensation.

In the cases here involved the Court of Appeals held it was bound and limited by the "clearly erroneous" rule of review while in the Bounds case the Court held, "We are not bound by the 'clearly erroneous' rule, Rule 52(a) of the Federal Rules of Civil Procedure, 28 U.S.C.A."

The decision and opinion of the Court of Appeals herein is likewise in conflict with the decision of the Court of Appeals for the Third Circuit in the case of *Thornley v. Commissioners of Internal Revenue*, 3 Cir., 147 F.2d 416, in a petition to review the decision of the Tax Court in a

case involving a deficiency in income taxes for the year 1937. The Court there held the case was subject to judicial review and that the Court might substitute its judgment for that of the Board.

The decision and opinion of the Court of Appeals herein is likewise, and for the same reason, in conflict with the decision of the Court of Appeals for the Ninth Circuit in the case of *Evans* v. *Commissioner of Internal Revenue*, 9 Cir., 264 S.W.2d 502, 514 (7); is in conflict with the decision of the Court of Appeals for the Seventh Circuit in the case of *Jennings* v. *United States*, 7 Cir., 272 F.2d 842, 845; and is in conflict with the decision of the Court of Appeals for the Fifth Circuit in the case of *Raymond Pearson Motor Co.* v. *Commissioner of Internal Revenue*, 5 Cir., 246 F.2d 509, 513 (1).

The decision of the Court of Appeals herein is likewise in conflict with the decision of the Sixth Circuit in the case of *Yunker* v. *Commissioner of Internal Revenue*, 6 Cir., 256 F.2d 130, where in a proceeding to review a decision of the Tax Court, the Court said (l.c. 133):

> "In a case where the evidence is, in all essentials, undisputed, an appellate court may exercise its independent judgment with respect to the ultimate fact question, when it could not do so in a case wherein contradictory evidence appears. Smith v. Dunn, 5 Cir., 224 F.2d 356. 'In so far, however, as the so-called "ultimate fact" is simply the result reached by processes of legal reasoning from, or the interpretation of the legal significance of, the evidentiary fact, it is "subject to review free of the restraining impact of the so-called 'clearly erroneous' rules." Lehmann v. Acheson, 3 Cir., 206 F.2d 592, 594.' Galena Oaks Corporation v. Scofield, 5 Cir., 218 F.2d 217, 219."

3. The Restricted Review Accorded Petitioners by the Court of Appeals Is Not in Accord with Law and Constitutes a Refusal to Exercise the Court's Lawful Jurisdiction and Duty under the Law.

We have pointed out under points 1 and 2 of these reasons for the allowance of the writ that the findings of the Tax Court are essentially ones dealing with the effect of certain transactions or events, rather than a finding which resolved disputed facts; they are at least determinations of mixed questions of law and ultimate fact, and as such, the Court of Appeals could, and should have accorded Petitioners a review of such scope as to allow the Court to substitute its judgment for that of the Tax Court as a matter of law if the record so warranted. *Bounds* v. *United States*, 4 Cir., 262 F.2d 876, 880; *Stevenot* v. *Norberg*, 9 Cir., 210 F.2d 615, 619; *Bogardus* v. *Commissioner of Internal Revenue*, 302 U.S. 34, 38-39, 58 S. Ct. 61, 64.

In restricting its review of the cases here involved to a determination of whether the rulings are "clearly erroneous" the action of the Court of Appeals was not in accord with law and constituted a refusal to exercise its jurisdiction and duty under the law to give Petitioners herein a full judicial review of the judgments of the Tax Court and to substitute the Court's judgment for that of the Tax Court as a matter of law if the record so warranted.

The Court of Appeals reached its conclusion upon an application of erroneous legal standards.

In the case of *Helvering, Commissioner*, v. *American Dental Company*, 318 U.S. 322, 330-331, 63 S. Ct. 577, in a certiorari proceeding wherein the Court of Appeals reversed the Board of Tax Appeals and this Court affirmed

the action of the Court of Appeals, this Court said (l.c. 582):

> "With this conclusion we cannot agree. We do not feel bound by the finding of the Board because it reached its conclusions, in our opinion, upon an application of erroneous legal standards. Section 22(b) (3) exempts gifts. This does not leave the Tax Court of the United States free to determine at will or upon evidence and without judicial review the tests to be applied to facts to determine whether the result is or is not a gift."

In the case of *Powers* v. *Commissioner of Internal Revenue*, 312 U.S. 259, 259-260, 61 S. Ct. 509, in ruling likewise in a similar situation to that in the *Helvering* case, *supra*, this Court said (l.c. 510):

> "The Commissioner determined a deficiency, claiming that the value of the policies for gift-tax purposes was the cost of duplicating them at the dates of the gifts, not the cash-surrender value as reported by petitioner. The Board of Appeals held that the value of the gifts was their cash-surrender value. The Circuit Court of Appeals reversed. 1 Cir., 115 F.2d 209. That judgment must be affirmed on the authority of Guggenheim v. Rasquin, supra, unless as claimed by petitioner the court below was precluded from substituting its judgment of value for that of the Board. Helvering v. Rankin, 205 U.S. 123, 131, 55 S. Ct. 732, 736, 79 L. Ed. 1343. But the question of what criterion should be employed for determining the 'value' of the gifts is a question of law. See Lucas v. Alexander, 279 U.S. 573, 49 S. Ct. 426, 73 L. Ed. 851, 61 A.L.R. 906. Accordingly, the Circuit Court of Appeals was justified in reversing the decision of the Board as 'not in accordance with law.' Int. Rev. Code 1939, § 1141 (c) (1), 53 Stat. 164, 26 U.S. C.A. Int. Rev. Code, § 1141(c) (1)."

The determination of what criterian should be employed in reviewing the facts on appeals in the Court of Appeals in these cases was a question of law. The determination of the Court of Appeals that the only test it could apply was the "clearly erroneous" test was error as a matter of law in applying an erroneous legal standard.

In the case of *Dobson* v. *Commissioner of Internal Revenue*, 320 U.S. 489, 492-493, 64 S. Ct. 239, in a certiorari proceeding to review the decision of a Court of Appeals which reviewed the decision of the Tax Court, this Court said (l.c. 242):

> "It is contended that the applicable statutes and regulations properly interpreted forbid the method of calculation followed by the Tax Court. If this were true, the Tax Court's decision would not be 'in accordance with law' and the Court would be empowered to modify or reverse it. Whether it is true is a clear-cut question of law and is for decision by the courts."

The refusal of the Court of Appeals to afford Petitioners the full judicial review of the Tax Court judgments as provided by law constitutes an error of law which, we respectfully submit, should be corrected by the Writ of Certiorari issued out of this Court.

This is a recurring question as pointed out under Points 1 and 2, *supra*, and that is an especial reason for granting the writ. *Cammarano* v. *United States*, 358 U.S. 498, 500, 79 S. Ct. 524, 526.

CONCLUSION.

Wherefore, your Petitioners pray that a Writ of Certiorari issue under the seal of this Court, directed to the United States Court of Appeals for the Eighth Circuit to the end that this cause may be reversed and remanded to

that Court to be reviewed and determined by said Court unrestricted by the "clearly erroneous" rule but given a full judicial review with the Court of Appeals left free to substitute its judgment for that of the Tax Court, if the record so warrants.

Walter A. Raymond

WALTER A. RAYMOND and
KENNETH C. WEST,
Counsel for Petitioners.

HARRY H. ELLIS,
of Counsel.

CERTIFICATE OF COUNSEL.

The undersigned, Walter A. Raymond, counsel of record for the Petitioners, Standard Asbestos Manufacturing and Insulating Company, Inc., and George M. Ryder, Executor of the Estate of Alice D. Ryder, Deceased, hereby certifies that the above and foregoing Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit is submitted in good faith and is believed to be meritorious.

Walter A. Raymond

WALTER A. RAYMOND.

APPENDIX

Section 23(a)(1)(A), 26 U.S.C.A. 1939, Sec. 23(a)(1)(A). Deductions from Gross Income.

"*In General*, all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity. In the case of any sports program conducted for the benefit of the American National Red Cross, expenses described in section 22(b)(16)(B) shall be allowable under this subparagraph only to the extent that such expenses exceed the amount excluded from gross income by section 22(b)(16)."

Section 22(b)-3 (26 U.S.C. 1939, Section 22(B)(3)). Exclusions from Gross Income.

"Gifts, bequests, devises and inheritances—The value of property acquired by gift, bequest, devise, or inheritance. There shall not be excluded from gross income under this paragraph, the income from such property or, in case the gift, bequest, devise, or inheritance is of income from property, the amount of such income. For the purpose of this paragraph, if, under the terms of the gift, bequest, devise, or inheritance, payment, crediting, or distribution thereof is to be made at intervals, to the extent that it is paid or credited or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property."

Section 29.22(b)-1 (Regulations 111). Exemptions—Exclusions from Gross Income.

"Certain items of income specified in section 22(b) are exempt from tax and may be excluded from gross income. These items, however, are exempt only to the extent and in the amount specified. No other items are exempt from gross income except (1) those items of income which are, under the Constitution, not taxable by the Federal Government; (2) those items of income which are exempt from tax on income under the provisions of any Act of Congress still in effect; and (3) the income exempted under the provisions of section 116. Since the tax is imposed on net income the exemption referred to above is not to be confused with the deductions allowed by section 23 and other provisions of the Internal Revenue Code to be made from gross income in computing net income. * * *"

Section 29.22(b)(3)-1 (Regulations 111). Gifts and Bequests.

"Property received as a gift, or received under a will or under statutes of descent and distribution, is not includible in gross income, although the income from such property is includible in gross income. If the gift, bequest, devise, or inheritance is of income from property, it is not to be excluded from gross income."

Section 29.23(a)-1 (Regulations 111). Business Expense.

"Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23(b) and 23(z), inclusive, and the regulations thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provision thereof. * * *

Among the items included in business expenses are management expenses, commissions (but see section 29.24-2) labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see section 29.23(a)-2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. Full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business. As to items not deductible under any provision of section 23, see section 24."

Section 29.23(a)-9 (Regulations 111). Pensions—Compensation for Injuries.

"Amounts paid by a taxpayer for pensions to retired employees or to their families or others dependent upon them, or on account of injuries received by employees, and lump-sum amounts paid or accrued as compensation for injuries, are proper deductions as ordinary and necessary expenses. Such deductions are limited to the amount not compensated for by insurance or otherwise. When the amount of the salary of an officer or employee is paid for a limited period after his death to his widow or heirs, in recognition of the services rendered by the individual, such payments may be deducted. As to deductions for payments to employees pension trusts, see section 23(p)."

Section 29.22(a)-1 (Regulations 111). What Included in Gross Income.

"Gross income includes in general compensation for personal and professional services, business income profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived

from any source whatever, unless exempt from tax by law (See sections 22(b), and 116). In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. Profits of citizens, residents, or domestic corporations derived from sales in foreign commerce must be included in their gross income; but special provisions are made for nonresident aliens and foreign corporations by sections 211 to 237, inclusive, and in certain cases, by section 251, for citizens and domestic corporations deriving income from sources within possession of the United States. Income may be in the form of cash or property."

Sec. 115 (86 U.S.C., 1952 Ed., Sec. 115). Distributions by Corporations.

"(a) Definition of Dividend.—The term 'dividend' when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time distribution was made."

EXHIBIT A.

T. C. Memo. 1958-42

TAX COURT OF THE UNITED STATES

STANDARD ASBESTOS MANUFACTURING AND INSULATING COMPANY, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.

ALICE D. RYDER, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket Nos. 60607, 60696. Filed March 18, 1958.

1. Petitioner, Standard Asbestos and Insulating Company, paid to each of its three officers for services rendered during the years 1949, 1950 and 1951, the sums of $52,232.14, $65,290.17, and $65,290.17, respectively. The officers and their families collectively held the majority of the stock in the corporation. They performed all the duties of the major officers of a corporation and estimated, bid, and supervised the work on all contracts of over $5,000. During the 1920's and 1930's their compensation was small. Evidence was presented, *inter alia*, of the compensation paid to officers in other companies in the industry. Other pertinent financial data, both with respect to petitioner company and with respect to other companies in the industry, was submitted. *Held, on the facts none of the compensation paid during the years in question was intended as compensation for services rendered in prior years. Held further, that the compensation paid to the officers in question for the years 1949, 1950 and 1951 was unreasonable to the extent herein determined.*

2. Petitioner company paid $13,012.50 to petitioner Alice D. Ryder, widow of its deceased president, which amount represented the probable amount of bonus which the president would have drawn for the first quarter of 1949, had he been alive at the end of the year, when bonuses were being determined. The president died on April 1, 1949, and before that date was the active head of the corporation. No employment contract existed between the company and the president, and there was no obligation for the company to pay the amount to his widow. Alice Ryder performed no services for the corporation and became a director of the corporation after the amount had been decided upon and accrued on the corporation's books. The amount was paid directly to her, and not to her husband's estate. The corporation deducted the amount on its return for 1949 as a payment to W. E. Ryder, and Alice Ryder included the amount in income in the year of receipt, 1950. *Held, the amount represented a gift and was not includible in Alice Ryder's income for 1950.*

3. The corporation had 500 shares of stock outstanding. During the years 1949-1951, inclusive, 446-1/2 of these shares were held by members of the Ryder family. Of the remaining shares, 26-3/4 were held by E. McElreath, the assistant secretary of the corporation, and 26-3/4 by Charles C. Knapp. These parties (other than Knapp) entered into a contract under date of February 17, 1949, in which they agreed to certain restrictions on the transfer of their stock. The agreement provided in part that should any of the Ryder brothers or their father die and leave their stock to their widow, or should the widow inherit any of their stock, the stockholders would cause the company to pay the widow, quarterly, 50 per cent of the average of the salaries of the father and brothers during the preceding quarters, so long as the widow held the stock. Pursuant

to this agreement, the stockholders caused the company to pay to Alice Ryder the amount called for in the agreement. *Held, the amounts were not deductible by the company, and were properly includible in Alice Ryder's income.*

4. The respondent determined additions to the income tax of Alice Ryder for the year 1950 under sections 294(d)(1)(A) and 294(d)(2). Alice Ryder failed to file declaration of estimated tax for 1950. Held, *that Alice failed to meet the burden of proving reasonable cause for failure to file such declaration and that additions to tax under the sections referred to are applicable.*

Harry H. Ellis, Esq., for the petitioners.

Claude R. Sanders, Esq., for the respondent.

Memorandum Findings of Fact and Opinion.

FISHER, *Judge*: In these consolidated proceedings respondent determined deficiencies in income taxes and additions to the taxes of petitioners as follows:

Docket No. 60607

Year	Deficiency
1949	$19,644.67
1950	40,843.10
1951	56,432.34

Docket No. 60696

Year	Deficiency	Additions to Tax Under Sec. 294(d)(1)(A)	Additions to Tax Under Sec. 294(d)(2)
1950	$11,128.84	$1,444.66	$963.10
1952	5,168.43	—	—

Many of the issues have been conceded by one or another of the parties, which will require entry of decision

under Rule 50 in any event. *The issues still contested are:* (a) The reasonableness of compensation for services rendered by three of the officers of petitioner, Standard Asbestos and Insulating Company, in the years 1949, 1950, and 1951; (b) Whether amounts accrued by petitioner Standard Asbestos and Insulating Company in 1949, 1950, and 1951, and paid to petitioner Alice D. Ryder in 1950 and 1952, are properly deductible by petitioner Standard Asbestos and Insulating Company, and properly excludible from the taxable income of petitioner Alice D. Ryder; (c) Whether or not the payment by petitioner Standard Asbestos and Insulating Company to petitioner Alice D. Ryder of $13,012.50 was excludible from Alice D. Ryder's taxable income in 1950, the year of receipt; (d) Whether or not petitioner Alice D. Ryder is liable for additions to tax under section 294(d)(1)(A); (e) Whether or not petitioner Alice D. Ryder is liable for additions to tax under section 294(d)(2).

FINDINGS OF FACT.

Some of the facts have been stipulated, either orally or in writing, and are incorporated herein by this reference.

Salary Issue.

Petitioner, Standard Asbestos Manufacturing and Insulating Company (hereinafter sometimes referred to as Standard), is a corporation organized in 1918 under the laws of the State of Missouri. Its original capitalization, which has not changed through the years, was $50,000, consisting of 500 shares of stock at a par value of $100 each. Standard was incorporated to do a general asbestos and insulating business and has developed into a technical specialties contractor organization handling all or part of the specifying, fabricating, manufacture, cost estimating,

erection and surface finishing in connection with highly technical construction work involving insulation, air conditioning, and temperature control installations. In performing such work, petitioner employs engineers, draftsmen, salesmen, district supervisors, superintendents, and various classes of skilled and unskilled labor. Petitioner's average number of employees during the years 1949, 1950 and 1951 (the years in question), was between 450 and 500, but because much of this labor was temporary and transient, obtained at the work site, the total number of persons working for petitioner at one time or another during the years in issue was approximately 1,500 to 1,600 persons.

At all times material hereto Standard was on an accrual basis of accounting. It filed its corporate income tax returns for the calendar years 1949, 1950 and 1951 with the collector of internal revenue for the eighth district of Missouri.

Standard's officers during the years 1949, 1950 and 1951 were Willard D. Ryder, president (acting president in 1949), George M. Ryder, treasurer and vice president (1950-51); Richard E. Ryder, secretary; and E. McElreath, assistant secretary. These persons, along with petitioner Alice D. Ryder (1950-51), also constituted the board of directors.

Willard E. Ryder was the father of Willard D., George M., and Richard E. Ryder, and the husband of Alice Ryder. Before coming to Kansas City in 1901, he had had experience in the insulation field as factory superintendent for Chicago Fire Proof Covering Company. After arriving in Kansas City, he entered into partnership with three others, doing business as Midland Asbestos Manufacturing Company. This partnership operated until the end of 1912.

In 1913, Willard E. Ryder entered into partnership with Ben C. Naylor, doing business as Standard Asbestos Manufacturing and Insulating Company. All the brothers worked for this partnership, both Willard D. and George working in the factory and in various manufacturing departments, and Richard, only 11 or 12 years of age, working at more menial tasks.

The corporate petitioner, Standard, was formed with the proceeds of insurance received when the partnership burned out in 1918, and with capital received from Mrs. E. P. Conger. The original stockholdings were in the following amounts:

Willard E. Ryder	5 shares
E. P. Conger	354 "
W. D. Ryder	61 "
Ben C. Naylor	60 "
Geo. M. Ryder	20 "
Total	500 "

Willard E. Ryder was elected the first president of the corporation and remained its president and chairman of the board of directors until his death on April 1, 1949. He was at all times before his sickness the actual head of the business. The corporation grew considerably in size over the years. Its sales volume for the year 1918 was $41,826.31. For the year 1951 it was $3,565,763.92.

By the year 1925, the Ryder family acquired a majority of the stock of the company. The stockholders of the corporation during the years 1949-1951 were as follows:

Owner	Amount
Willard E. Ryder	41-1/2
Alice D. Ryder (wife)	6
Willard D. Ryder	66-1/2
Merle H. Ryder (wife)	66-1/2
George M. Ryder	86
Iris B. Ryder (wife)	47
Richard E. Ryder	66-1/2
Hazel M. Ryder (wife)	66-1/2
Elizabeth McElreath	26-3/4
Charles C. Knapp	26-3/4

George, Willard and Richard Ryder have had long and outstanding careers with the company. They all worked for the company in various capacities immediately after its incorporation, and by the late 1920's were obtaining inquiries from substantial customers, securing large contracts, estimating jobs, bidding on them, closing contracts, supervising work in the field, collecting accounts, and, when necessary designing new installations and equipment.

After the death of Willard E. Ryder, his duties were divided with substantial equality among the three brothers. They continued to perform his duties through 1951. From the date of his father's death, Willard D. Ryder held the office of president (acting president in 1949). His duties in this capacity included acting as sales manager, engineering director, Kansas City district manager, and Denver district manager. In addition, he accepted all contracts for the company, helped determine cost prices and selling prices; was responsible for billing and invoicing,

determined estimating procedures, and performed the ordinary duties of president of a corporation.

George M. Ryder, after his father's death, became general office manager, in which position he was responsible for the financial relations of the company, its supplier and distributor relations, its customer credit limits, all accounting (including cost accounting), purchasing, collections, and company disbursements. He was also vice president and treasurer of the corporation and helped determine costs and selling prices.

Richard E. Ryder, after his father's death, was directly responsible for all requisitions, job supervision, and field supervision in the Gulf and south central area of the United States. His duties included the supervision of work, and the responsibility for branch payrolls and expense accounts. He was secretary of the company, and assisted in estimating work, and in developing new products. During the years in question, Richard suffered from a heart condition, and underwent surgery in 1950. After a recuperative period of three months, he again resumed his duties.

While the company employed branch managers, supervisors, draftsmen, engineers, salesmen and the like during the years in question, all employees were under the direct supervision of at least one of the brothers. No one other than the three Ryders was allowed to handle contracts amounting in sales price to over $5,000. The estimating, bidding, and supervision of contracts in excess of that amount were handled by either George, Willard, or Richard. The Ryders also obtained most of the inquiries on substantial contracts, although occasionally others in the organization helped in that regard. During the years in question no employee of Standard other than officers was paid more than $9,000 per year. Each of the brothers de-

voted greatly in excess of 40 hours per week to the business during the periods here material.

Defense work performed by the company during the Korean War amounted to between 25 per cent and 33 per cent of sales for each of the years 1950 and 1951. The company's performance was highly complimented by the Renegotiation Board, which approved the maximum profit allowable to contractors. The Board did not question the brothers' compensation.

The brothers drew currently $70 per week during the years in question. The remainder of their compensation was paid to them in the form of a bonus. The compensation deducted by Standard in 1949, 1950, and 1951 was authorized by the board of directors as follows:

Minutes of October 3, 1949:

> In consideration of the constantly increasing volume of business being handled by the Company and recognizing the resultant increase in responsibility levied upon the officers, multiplying the demands upon their time, their energies, etc., it is directed that compensation to officers and key personnel be authorized and approved up to, but not to exceed, the following annual amounts:
>
> | | |
> |---|---|
> | W. D. Ryder, Acting President | $67,500.00 |
> | R. E. Ryder, Secretary | 67,500.00 |
> | G. M. Ryder, Treasurer | 67,500.00 |
> | E. McElreath, Assistant Secretary | 15,000.00 |
> | Branch Managers, drawing accounts | 8,500.00 |
> | Superintendents, drawing accounts | 8,000.00 |
>
> Any salary adjustments shall be handled individually and at the studied discretion of the Acting President, but in any event, all such salaries must be held within the maximum limits herein established and must be, in the opinion of the Acting President, consistent with the earning of the Company.

In the minutes of December 1, 1949, after a report on the "highly satisfactory financial condition of the company," and approval of a 10 per cent dividend; the following motion was adopted:

> in view of the report just submitted by the Treasurer, that additional salary be paid to all officers for the year 1949, in keeping with the increased earnings of the Company and that such additional salary be in the amounts as determined and designated by Acting President of the Company, W. D. Ryder, and within the limits previously authorized by the Board of Directors.

The compensation authorized by the president for the year 1949, payable to each brother pursuant to these minutes, was $52,232.14.

The minutes of July 3, 1950, contain, *inter alia*, the following:

> G. M. Ryder, Treasurer, reported that a tentative appraisal of Company's cash position at close of first half of 1950 fiscal year, indicated the following:

Cash on hand	$361,000	A cs Payable	$49,000
A cs Receivable	294,000	Bank Loan Houston	60,000
		Property Loan	11,000

> Thus reflecting a highly satisfactory liquid condition, and in addition, the existence of a very gratifying back-log volume, all of which conceivably should result in a profitable 1950 year.
>
> R. E. Ryder moved, that in-as-much as the Company's finances indicated a sound liquid status that in view of the increasing time and effort expenditure being required of the officers, in the administration of Company affairs, and in line with increases already granted to the executive and supervisory employees at the various offices, that compensation of all officers

for the 1950 year be increased up to 25% beyond the compensation paid the officers for the 1949 year. The exact percentage increase to be designated by the President, with the 25% figure to maintain as maximum.

The minutes of December 4, 1950, report "as to the present highly satisfactory financial condition" of the company. The following motion was thereupon adopted:

in view of the report just submitted by the Treasurer, that additional salary be paid to all officers for the year 1950, in keeping with the increased earnings of the Company and that such additional salary be in the amounts determined and designated by the President of the Company, Willard D. Ryder, and within the limits as previously authorized by the Board of Directors.

The amount of compensation authorized by the president to be payable to each of the three brothers for the year 1950 was $65,290.17.

The minutes of October 10, 1951, contain a report on the financial condition of the company, stressing the fact that large amounts of assets were tied up in accounts receivable for the rest of the year, and extending into 1952. The minutes continue:

Based upon the above report, R. E. Ryder then introduced the following Motion: "In consideration of the fact that profits for 1951 operations evidence substantial proportion, but in-as-much as it is early to definitely calculate a probable total, that additional compensation be paid to all officers—in amounts as established and instructed by President W. D. Ryder, it being understood, however, that resulting total compensation will not exceed total for the year 1950; and that full consideration be given by W. D. Ryder to determined profits and cash requirements in keeping

with the needs of the business, in arriving at compensation amounts.

By the authority stated in the above minutes, the president fixed compensation for 1951 at $65,290.17, the same amount as for 1950.

The parties have stipulated that compensation paid to Richard, George, and Willard, respectively, during the long period the brothers served Standard was dependent upon the cash position and the financial condition of the company. The compensation was also dependent on the earnings and profits of the corporation.

As early as December 31, 1921, the board of directors of petitioner corporation gave authority to the chairman of the board to set aside additional compensation as bonus to officers and heads of departments "as the profits resulting from the business may warrant, in the judgment of the managing directors," except that additional compensation be made available "only as the financial condition of the Company may be in condition to conveniently allow such withdrawals." In 1928, because the company was short of working capital, losing money, and raising the quality of the company's product, the board resolved that the president could curtail drawing accounts and that the authority to allow additional compensation as bonus be withheld temporarily, "until, and providing business conditions improve to such extent that board can feel justified in allowing such withdrawals on compensation account without the hazard of continued losses."

The authority to allow bonuses was withheld until 1937. During the period between 1928 and 1937, the compensation paid the brothers by Standard was very small, amounting to as little as $910 each per year in 1933 and 1934. By motion of December 20, 1937, the board voted

to resume bonuses and pay back bonuses (theretofore suspended) for the years from 1928 on. Authority was given at the same time to make present payment of bonuses for the years 1928, 1929, and 1930. In 1938 and 1939, the salary of each of the brothers was supplemented by amounts considered to be due them as salary (bonus) withheld in back years.

Willard D. Ryder left Standard in 1922 to work for Armstrong Cork Company. He returned to Standard in 1927. When he left Armstrong Cork he was being paid $360 per month. His salary upon his return to Standard was approximately $205 per month. He returned because of the influence exerted by his father and brothers who persuaded him that the four Ryders could go a lot further together than individually, and that if the compensation was then low, it would not always be so. In 1929, George M. Ryder was loaned to Barrett Company, who paid him $400 per month. At this time his salary from petitioner was $40 per week or $2,080 per year. While with Barrett, that company offered George an increase from $400 to $500 per month if he would stay in its employ. George refused the offer, due mainly to influence exerted by his family persuading him that his place was in Kansas City.

Willard E. Ryder intended that the company's sals volume reached $1,000,000 the salary paid to the brothers would be increased to some point which would be consistent with what was being paid in the industry. This goal was reached in 1941. The following schedule shows the sales volume of the company from 1942 to 1951, inclusive, the aggregate amount of compensation authorized by the board and paid to the brothers for services, (each received the same amount), the aggregate amount received by the brothers before the end of the years in which the work was

performed, and the aggregate amount allowed and disallowed by respondent for the years in question:

Year	Sales Volume	Authorized and Deducted	Received During Year	Allowed	Disallowed
1942	$2,055,312.66	$ 45,000.00	$32,460.00		
1943	2,690,437.27	60,000.00	60,000.00		
1944	1,149,537.94	45,000.00	45,035.01		
1945	1,600,037.11	52,465.00	44,964.99		
1946	1,653,529.33	37,500.00	17,730.00		
1947	1,751,199.34	60,000.00	5,460.00		
1948	2,402,590.17	90,000.00	42,280.80		
1949	2,633,679.78	156,696.42	41,340.00	$105,000	$51,696.42
1950	2,578,287.24	195,870.51	57,515.01	120,000	75,870.51
1951	3,565,763.92	195,870.51	10,920.00	120,000	75,870.51

Each brother's 1940 compensation was $2,100. This amount was increased by the board to $11,000 each in 1941 because the board recognized that the officers had received inadequate salaries prior to that time as part of the plan to bring the company "to its present financial status," and to allow it to accumulate working capital. In 1942, as indicated by the minutes, the board increased the maximum compensation to each brother to $20,000 in recognition of the low salaries paid theretofore, and because the company was doing a larger volume with the same overhead so that earnings would be up. The sum of $15,000 each was the amount finally paid to the brothers for that year. In 1943, salaries were frozen, and the amount paid the brothers was the maximum provided in 1942. The 1946 salary was reduced because of the company's then unfavorable cash position. The 1947 salary was increased because of the company's then favorable cash position.

The amounts paid during each of the years 1949, 1950, and 1951, the years in question, were intended to compensate only for services performed during each of those years. No arrangement, agreement, or understanding existed between Standard and the Ryders that any part of the com-

pensation paid them for the years 1949-1951, inclusive, was to be in payment for services performed in prior years, nor did any amount paid for each of said years represent such payment.

The compensation for 1949 was determined in the following manner. First, the 1942 compensation was increased by a factor of 2.5, which represented the parties' estimate of the increase in labor cost over 1942. To the resulting amount was added the amount which Willard E. Ryder would have been paid for the last three quarters of 1949, based upon the same formula. (The amount Willard E. Ryder would have been paid for the first quarter of 1949 is discussed in connection with petitioner Alice Ryder.) The total derived by the above computations was divided equally among Willard, George and Richard. The compensation for 1950 and 1951 was determined by increasing 1949 compensation by 25 per cent.

Pertinent operating and financial data of petitioner for the years 1942-1951, inclusive, is as follows:

Year	Net Sales	Gross Profit*	Net Income*	Year End Surplus	Officers' Salaries Deducted	Net Income After Officiers' Salaries
1942	$2,055,312.68	$538,233.16	$266,200.92	$296,294.64	$ 65,000.00	$201,200.92
1943	2,690,437.27	696,549.94	334,677.61	338,852.32	85,000.00	249,677.61
1944	1,149,537.94	378,307.02	99,308.73	387,507.39	65,000.00	34,308.73
1945	1,000,037.11	388,562.20	121,565.51	407,526.83	74,953.32	46,612.19
1946	1,653,529.33	413,422.03	107,476.14	431,985.27	60,000.00	47,476.14
1947	1,751,199.34	437,612.41	139,208.26	457,029.10	90,000.00	49,208.26
1948	2,402,590.17	548,212.68	232,105.81	509,969.16	135,000.00	97,105.81
1949	2,633,673 78	743,445.71	397,126.93	627,794.65	182,008.92	215,118.01
1950	2,578,287.24	846,186 49	451,098.62	710,474.79	209,933.01	241,165.61
1951	3,565,763.92	803,181.38	351,045.82	752,999.86	209,933.01	141,112.81

*Before salaries subtracted.

The ratio which the brothers' compensation bears to net sales and to net income before salaries and the ratio which total officers' salaries bears to net sales and to net income before salaries is indicated in the following schedule:

Year	Brothers' Compensation	Brothers' Compensation	Officers' Salaries	Officers' Compensation
	Net Sales	Net Income	% Sales	Net Income
1942	2.2%	17%	3.1%	24%
1943	2.2%	18%	3.2%	25%
1944	3.9%	45%	5.7%	65%
1945	3.3%	43%	4.7%	61%
1946	2.3%	35%	3.6%	55%
1947	3.4%	43%	5.1%	64%
1948	2.7%	39%	5.6%	58%
1949	6	39%	6.9%	46%
1950	2.2%	43%	8.1%	47%
1951	3.3%	56%	5.9%	60%

Petitioner paid dividends in 1941 of $7,500. In 1942, it paid no dividends and in each of the years 1943 to 1951, inclusive, it paid dividends of $5,000.

The Asbestos and Magnesium Materials Company of Chicago is a corporation engaged in the same general line of work as Standard. Pertinent financial data of the corporation for the years 1949-1951, inclusive, is set forth below:[1]

[1] See infra as to substantial compensation of the two corporation

Year	Net Sales	Brothers' Compensation	Officers' Salaries Net Income	Pension	Net Income Net Sales
4/30/49	$4,000,000	$30,000	$55,000	$20,000	3.9%
4/30/50	5,500,000	80,000	30,000	10,000	2.2%
4/30/51	4,450,000	30,000	30,000	10,000	2.7%
4/30/52	4,270,000	80,000	32,000	10,000	2.9%

The president of Asbestos and Magnesium Materials Company during 1949-1951, inclusive, founded the com-

pany in 1920. He had 10 years experience at the time the company was organized and put in more than 48 hours a week in the business during the years in question.

The vice president of the company in 1949 had had 25 years experience and worked in excess of 48 hours a week with the company. The vice president in 1950 and 1951 had 28 or 29 years experience and had been treasurer of the company in 1949. The treasurer of the company in 1950 and 1951 had had experience in the accounting and investment field and was with the company about 10 years.

Two men with 15 to 20 years experience each, who did only sales work for Asbestos and Magnesium Materials Company, and who were paid on a commission basis, averaged $40,000 to $45,000 per year each during the years 1949-1951, inclusive.

Asbestos and Magnesium Materials Company paid dividends of $50,000 in each of the years 1949 to 1951, inclusive. It had a capitalization of $500,000 consisting of 5,000 shares of common stock with a par value of $100 each. The president owned about 95 per cent of the stock.

The Kelley Asbestos Products Company is a corporation engaged in the same general line of work as Standard. Pertinent financial data of the corporation for the years 1949-1951, inclusive, is set forth below:

Year	Net Sales	Gross Profit	Net Income*	Pres.'s Salary	Pres.'s	Dividends Paid
1949	$1,736,446.40	$277,883.21	$ 73,033.04	$16,000	1.1%	$ 9,354
1950	1,453,206.17	263,600.53	36,155.94	26,000	1.7%	**
1951	2,274,774.09	520,790.94	259,126.53	26,000	1.1%	12,6**

*After salaries, but before taxes

**No information available

Kelley Asbestos Products Company had approximately 1100-1300 shares of stock outstanding during the years in question, with a par value $100, of which David E. Kelley, the president owned 1,000 shares. David Kelley has been in the business since 1912, and in 1932 formed the present organization which was operated as a partnership until 1947.

The compensation paid by Standard to George, Richard and Willard for each of the years 1949, 1950 and 1951 was in excess of reasonable as to each for the services rendered. *Reasonable compensation for services rendered by each of the brothers was $42,500 for the year 1949 and $47,500 for each of the years 1950 and 1951.*

Payment of $13,012.50.

Willard E. Ryder died on April 1, 1949. Prior to that time he had been the active head of the business. His compensation, like that of his sons, was not fixed by written contract with the company, but, since at least 1941, was fixed each year on the basis of the financial condition and the earnings of the company for the year. His compensation was ordinarily 20 to 25 per cent greater than that paid to each of his sons. Willard E. Ryder, by his usual drawings of $70 per week received $1,050 from the company as compersation for the first 15 weeks of 1949. At the close of that year, when compensation to officers was being determined, the company paid to Alice Ryder $13,012.50, which sum represented the bonus, or compensation, which Willard E. Ryder would have received for the first quarter of 1949 under the formula outlined *supra*, whereby the 1942 salaries were increased by a factor of 2.5.

There is no evidence of any action by the board of directors authorizing this payment. There was no obligation on the part of the company to pay any amount to Alice

Ryder, as widow of Willard E. Ryder. Willard E. Ryder was the first officer of the company to die, and this marked the first time on which there was occasion to consider death benefits to the wife of a deceased officer, although retirement benefits had been paid to other employees as the occasion arose. (See *infra.*) The amount of $13,012.50 was accrued by the company and deducted on its return for 1949 as part of a payment to W. E. Ryder. The amount was actually paid on March 4 1950, to Alice, who reported her income on the cash basis, and included the amount in her income tax return for 1950.

At no time did Alice render services to the company except as director. She was elected a director in January 1950, after the payment to her had already been determined. She owned 47-1 2 shares of the company's stock out of a total of 500 shares outstanding prior to and at the time the amount in question was accrued and paid. The officers of the company intended the payment to be a gift. *The amount of $13,012.50 paid by the company to Alice Ryder represented a gift from the company to Alice Ryder.*

Pension Issue.

On February 17, 1949, an agreement which, *inter alia*, gave an option to the named stockholders to purchase the stock of other named stockholders under certain contingencies, was entered into among the parties stated, and included the following provisions:

AGREEMENT

THIS AGREEMENT, made and entered into this 17th day of February, 1949, by and between W. E. Ryder, Alice D. Ryder, Willard D. Ryder, Merle H. Ryder, George M. Ryder, Iris B. Ryder, Richard E. Ryder, Hazel M. Ryder and E. McElreath (hereinafter

sometimes separately referred to as a "Stockholder" and collectively referred to as the "Stockholders".

WITNESSETH:

WHEREAS, the Stockholders presently or prospectively own substantially all of the common capital stock (hereinafter referred to as the "Shares") of Standard Asbestos Manufacturing and Insulating Co., a Missouri corporation (hereinafter referred to as the "Company"), and

WHEREAS, the Stockholders have agreed among themselves with respect to certain restrictions upon the transfer of the Shares, and desire to reduce said agreement to writing;

NOW THEREFORE, in consideration of the premises, the mutual covenants herein contained, and the mutual benefits to be derived herefrom, the sufficiency of such consideration being hereby acknowledged, it is understood and agreed between the parties as follows:

* * * * * * *

ARTICLE III

If W. E. Ryder, Willard D. Ryder, George M. Ryder, or Richard E. Ryder shall leave all of his Shares to or for the benefit of his widow in his Last Will and Testament, either outright or in trust for her life, or if all of such Shares shall descend to such widow by operation of law, the Stockholders will cause the Company to pay a pension to such widow so long as she retains all of such Shares (or such trust continues and the trustee retains all of such Shares) and she does not remarry. Such pension shall be paid quarterly, and shall be the equivalent of 50% of the average of the salaries paid by the Company during the preceding quarter to W. E. Ryder and his lineal descendants.

* * * * * * *

Standard was not a party to this agreement. Pursuant to the terms of the agreement, the shareholder-signatories thereto, who owned 473-1 4 shares of the 500 shares outstanding, caused the corporation to authorize payment to Alice Ryder of the amount called for by Article III thereof by unanimously adopting a motion which was recited in the minutes of July 5, 1949, as follows:

> The Chairman advised the Board of Directors that, pursuant to Article =3 of an Agreement executed by the stockholders of the Company on February 17, 1949, Alice D. Ryder, widow of our late President, W. E. Ryder, was entitled to a pension from the Company equivalent to 50% of the average of the compensation paid by the Company to the lineal descendants of W. E. Ryder. A motion was made by G. M. Ryder that the terms of said contract be complied with and that the Treasurer be instructed to pay such pension to Alice D. Ryder, beginning as of April 1, 1949, and to pay the same semi-annually or quarterly, as the Treasurer may elect, such payments to continue until the further order of this Board.

During the years in question the amounts Alice Ryder received pursuant to the agreement and motion, as set forth above, along with the amounts she reported in her income tax returns are shown below:

	Reported	Received
1950	$ 6,876.44	$27,367.40
1952	28,225.00	32,645.09

Respondent increased Alice Ryder's income by the amount of $20,491.08 for the year 1950, a $5,300.08 for the year 1952, on account of the payments received by her by virtue of the aforesaid agreement and motion. Respondent now concedes that $1.88 for 1950 and $909.99 for 1952 were erroneously included in Alice Ryder's income.

Standard accrued the amounts payable to Alice on its books each year. Small amounts were paid in each year of accrual, the balance being paid in the succeeding year. No deduction for the amounts accrued was taken by the company on its income tax returns for the years in issue. The company made retirement payments to employees which, with social security, amounted to 50 per cent of their average yearly salary during the years they worked for the company.

The amounts paid to Alice by Standard, pursuant to the agreement and motion of the board of directors, constituted a distribution of profits and not a pension.

Issue re Additions to Tax.

Alice Ryder was 84 years old in 1950. Her income tax returns were prepared by Edwin J. Yentzer, a certified public accountant, who also did work for Standard.

Alice Ryder did not file a declaration of estimated tax or pay an estimated tax for the year 1950.

OPINION.

Salary Issue.

With respect to the reasonableness of the salaries deducted by Standard in 1949, 1950 and 1951, petitioner argues alternatively that the compensation included amounts intended to reimburse the brothers for services performed in prior years, or that the compensation was reasonable on the basis of services performed by the brothers in the years in question. *We think it clear from the record that petitioner has failed to establish that the compensation deducted in 1949, 1950 and 1951 had any ascertainable relationship to services performed in prior years.*

The years in which the brothers received a low income from the corporation were in the period of the 1920's and 1930's. During this time the brothers chose to work for Standard rather than other companies though they had ample opportunity to work for others. Whether or not their choices were prompted by understandings that when the company was in a position to pay larger salaries, the brothers would be compensated for any year at a rate in excess of the value of their services to the company during that year, there is no evidence that part of the compensation authorized for 1949, 1950 and 1951 was so intended. Cf. *Lucas* v. *Ox Fibre Brush Co.*, 281 U.S. 115.

Petitioner relies on the following testimony in the record:

By George M. Ryder [with reference to Willard's return in 1927]:

> My younger brother and my father cornered him and talked him into coming back into the business with the promise that although he would temporarily have to work for less money than he was drawing, that as the business was built up he would be reimbursed for the time at which he drew lesser money.

By Willard D. Ryder [with reference to his return in 1927]:

> They pointed out that we could go a whole lot farther together than we could individually, and they promised that later on it would be made up to us.

By Willard D. Ryder [with reference to his father's attitude towards compensation]:

> His position was always, when your volume reached a million dollars we could talk about it then, we could talk about salaries to some point which was relative with what was being paid in the trade.

We note that there is some difference between George's third party account of what was promised to influence Willard to return, and Willard's much less definite account of the same promises. We note, more significantly that in describing his father's attitude, Willard clearly states that his father's position was always to bring salaries into line with going rates in the industry when the million dollar volume was reached. When all of the above testimony is examined, along with the minutes of the corporation in 1928, 1937, and 1939 (referred to in our Findings), first withholding extra compensation and then allowing reimbursement for the amounts withheld, and when consideration is also given to the testimony that the amounts authorized by the minutes for reimbursement were paid, we think that the evidence negatives petitioner's argument to the effect that part of the compensation received in each of the years 1949, 1950 and 1951 was intended as reimbursement for services performed in prior years. Especially is this so when it is considered that compensation for the years 1941-1948, inclusive, is substantial; that the minutes for 1941 and 1942 indicate that some part of the compensation paid for that period was intended as reimbursement for prior years' services; and that the minutes authorizing compensation for 1949, 1950 and 1951, make no mention of an intention to reimburse for prior years' services, but on the contrary, indicate that compensation was determined on the basis of then existing conditions. It should be recalled, also, in this connection that the Ryders controlled the company. *For these reasons we hold that the compensation in question was intended to be paid for services rendered in the year for which the compensation was authorized, i. e., each of the years 1949, 1950 and 1951.* In any event, it is clear that petitioner has failed to carry its burden of proving the contrary. See *E. B. & A. C. Whiting Co.*, 10 T.C. 102, 117, 118 (1948).

We recognize that it is not an unreasonable business practice "for an employer to recognize and reward sacrifices made by employees in the hard formative days by granting a more generous compensation in the days that are lush." Commercial Iron Works v. *Commissioner*, 166 F.2d 221, 224 (C.A. 5, 1948). *There is, however, no indication that petitioner here so intended for the years in question and, as we have said, we think the evidence points the other way.* Cf. *Christman Co.*, 8 T.C. 679 (1947), affd. on other grounds 166 F.2d 1016 (C.A. 6, 1948).

We consider, therefore, whether or not the compensation in question was reasonable in the light of the services rendered by the brothers during the years in question. In determining the reasonableness of salaries, all the elements of the particular case must be considered as disclosed by an analysis of the record. *Heil Beauty Supplies* v. *Commissioner*, 199 F.2d 193 (C.A. 8, 1951), affirming a Memorandum Opinion of this Court dated December 13, 1950; *The Barto Co.*, 21 B.T.A. 1197 (1931).

The minutes of the company indicate that the board of directors considered the compensation reasonable. While the decision of the board is a factor to be considered, it is not, of course, controlling upon us, but it is to be weighed in the light of all of the circumstances of the case. *L. Schepp Co.*, 25 B.T.A. 419, 429 (1932). The action of the board must be examined closely, particularly in a case involving the reasonableness of salaries paid to officers in a closely held corporation in which the officers are also the majority shareholders and directors, with a view to determining whether or not any part of the amount designated as salaries may in fact represent a distribution of profits under the guise of compensation. *Miles-Conley Co.* v. *Commissioner*, 173 F.2d 958, 960 (C.A. 4, 1949), affirming 10 T.C. 754; *Crescent Bed Co., Inc.*, v. *Commissioner*,

133 F.2d 424 (C.A. 5, 1943), affirming 46 B.T.A. 1280; *Marble & Shattuck Chair Co.*, 39 F.2d 393 (C.A. 6, 1930), affirming 13 B.T.A. 657.

We first consider the year 1949. Respondent allows a salary of $35,000 to each brother for that year, recognizing, in effect, an increase of $5,000 to each over their salaries for 1948. His determination is *prima facie* correct, and the burden lies with the corporate petitioner to show error. The company fixed the amount of salary to each brother at $52,232.14, an increase to each of $22,232.14 over 1948. *We think it clear that the corporate petitioner has failed to prove that the amounts so fixed are reasonable. At the same time, we think the record justifies salaries to each brother in excess of the amounts determined by respondent.* In reaching this conclusion, and in determining, *infra*, the amounts which we hold to be allowable, we have given careful consideration to all of the evidence in the record, including that relating to the services performed by the brothers; their industry, capacities and versatility; the financial data presented; the method (formula) by which their salaries were calculated by the company; the information in the record as to compensation to officers by other organizations whose business activities bore some relationship to those of petitioner; the opinion evidence offered in connection therewith, and all other relevant factors set forth in our Findings and in the stipulation of the parties. It would serve no useful purpose to repeat or summarize all of these considerations in our Opinion. We think it appropriate, however, to mention several factors.

We think the record demonstrates that the progress of the company in 1949 is attributable in some measure to the services of the three brothers. The father, who had been the leader, died on April 1, 1949. The brothers took over his duties, allocating them substantially equally to each

brother. The net income of the company increased from $232,105.81 (before officers' salaries) in 1948, when the brothers' compensation was $30,000 each, to $397,126.93 in 1949. This last factor is not to be overemphasized, because net sales did not increase in anything like the same proportion, and it is obvious that profits may fluctuate from year to year for reasons not attributable to officers' services (net profits before salaries increased in 1950, although net sales decreased slightly, while net profits before salaries decreased somewhat in 1951 although net sales materially increased). Nevertheless, we think that a substantial increase in earnings tends to support the view that the brothers, together, ably and successfully took over the entire management of the business. As mentioned above, we have given some consideration to the "formula" upon which the salaries were based. We think it is an indication of an effort at consistent treatment of the problem. We do not, however, attribute to it the weight with which petitioner would have us regard it. We do not think a relationship of officers' salaries to labor cost is controlling, or essentially sound, particularly in the light of changing conditions from 1942 (and prior thereto) through 1949.

We, of course, have noted that petitioner introduced testimony of the vice president of a somewhat similar organization who testified that the compensation determined by the company was reasonable, but his appraisal was based mainly on his rule of thumb opinion that any amount for total officers' salaries representing 5 to 6 per cent of sales was reasonable. In this connection, however, we also note that for each of the years 1949 and 1950, the combined officers' salaries came to more than 6 per cent of sales. We have considered the testimony of the witness and have utilized it to a limited degree in reaching our conclusion, but we do not consider ourselves bound by his ultimate opinion. An

indication that an opinion based upon a ratio of officers' compensation to sales is not to be accepted without reservation appears from facts already referred to showing that net sales for 1950 decreased below the 1949 figure, although, at the same time, net income before officers' salaries increased, while, in 1951, on the other hand, net sales increased materially, but net income before officers' salaries was less for that year than either 1949 or 1950.

In all events, we conclude, upon consideration of all relevant factors, with some emphasis upon the taking over of the father's duties after April 1, 1949, and the continued success which attended the changeover, that part of the father's probable compensation, if he had lived, should be allocated equally to the brothers for 1949 and that the success of the company in 1949 should be reflected in the amount of compensation determined.

It is our judgment, in the light of the foregoing, that, for the year 1949, an increase in the compensation of each brother of $12,500 over 1948 compensation is justified by the record, resulting in the allowance of total compensation to each in the amount of $42,500 for the full year 1949.

Respondent allowed $40,000 as compensation to each brother for each of the years 1950 and 1951 (an increase of $10,000 to each over 1948). *His determination is prima facie correct. Our analysis of the problem of compensation for the brothers in 1949, and our further consideration of the record relating to 1950 and 1951, leave us with no doubt that the corporate petitioner has failed to meet the burden of proving that compensation fixed by the company at $65,290.17 for each brother for each of the years 1950 and 1951 was reasonable. The increase adds 25 per cent to the compensation of each as fixed by the company for the year 1949. The record does not, in our judgment, furnish a basis for such increases.* We think it unnecessary

to repeat our own discussion of 1949 compensation as background for discussing 1950 and 1951. We think that in essential respects the business was neither more nor less successful and that the services of the brothers were not, to any substantial extent, more valuable or extensive in 1950 and 1951 than in 1949, except for the fact that in 1950 and 1951, the brothers, together, were in complete charge of the entire management of the business and were in full stride as such for the entire year, instead of taking over and managing the business for nine months, as in 1949. It is true that net income before officers' salaries increased in 1950, but net sales dropped off slightly. On the other hand, in 1951, net sales materially increased, but net profits before officers' salaries dropped below 1949. We have no doubt that Korean War conditions were in part responsible for the variations in 1950 and 1951, but the over-all picture from the standpoint of compensation does not, in our judgment, vary materially from 1949. We note the fact that the Renegotiation Board did not question officers' compensation, and we have given consideration thereto, but we do not know what record was before the Board, and absence of action on the part of the Board is clearly not binding upon us or upon respondent. *Kerrigan Iron Works, Inc.*, 17 T.C. 566, 573 (1951).

Consistent with the foregoing, we conclude that compensation of $47,500 is properly allowable to each brother for each of the years 1950 and 1951, representing an annual increase of $5,000 to each over compensation for 1949.

Payment of $13,012.50.

With respect to the payment of $13,012.50 to Alice Ryder, respondent challenges only the allegations of Alice Ryder that the amount represented a gift rather than taxable income. *The resolution of this question depends upon*

the intentions of the parties, particularly that of the employer, which intention must be gleaned from the circumstances surrounding the transaction. Estate of Frank J. Foote, 28 T.C. 547, 549 (1957). *We think the payment represented a gift.*

Alice Ryder performed no services for the company at the time of the accrual of the payment in question. She owned only 47-1/2 shares of the 500 shares of stock outstanding, although control of the stock was in her family. The amount was paid directly to her and not to her husband's estate. There was no obligation on the part of the company to make such payment to her. *These facts were present in Estate of Arthur W. Hellstrom,* 24 T.C. 916 (1955), *and were deemed* sufficient there to support the view that the payment was a gift. *We think the facts stated above outweigh any indications to the contrary, and support a holding that the payment was not taxable income. Estate of Frank Foote, supra; Florence E. Carr,* 28 T.C. 77., 781 (1957), on appeal (C.A. 2); *Florence S. Luntz,* 29 T.C. (Filed January 13, 1958).

Respondent argues that the company deducted the accrued amount on its tax return and that Alice included it in her 1950 return as taxable income. These circumstances, while factors to be taken into consideration, are not controlling and, of themselves, do not require a conclusion contrary to the one we have drawn. *Estate of Arthur W. Hellstrom, supra; Estate of Frank J. Foote, supra.*

Respondent argues that there was no authorization for the payment and, therefore, that there can have been no gift. We agree that the record does not show any formal authorization. There is no dispute, however, that Alice received the amount of $13,012.50 in 1950, and there is convincing oral testimony that it was intended as a gift to her.

Respondent argues further that since the amount paid was computed on the basis of the amount which W. E. Ryder had earned during the first quarter of 1949, the amount represents compensation.

We need not decide whether the equivalent of the amount paid to Alice was earned by and should be deemed to be income to W. E. Ryder or his estate, since his taxes and those of his estate are not before us. Assuming that it should have been so treated, or that the payment to Alice was measured by compensation which would have been paid to W. E. Ryder, we note, as we noted in *Estate of Arthur W. Hellstrom, supra*, that gifts to widows are frequently determined by the amount which an officer or employee would have earned had he lived. Assuming, *arguendo*, that the amount was earned prior to the death of W. E. Ryder, that fact would not alter our conclusion that the amount was not taxable income to Alice Ryder. In *Florence E. Carr, supra*, where the corporation was bound by contract to pay over to the employer's widow, in installments, amounts earned by the employee before the contract was entered into, we held that the amounts did not constitute taxable income to the widow. And in *Estate of John A. Maycann*, 29 T.C. 81, where respondent argued that a bonus which had been paid to the widow in an amount equal to that which had been paid consistently to the deceased in prior years, should, because the practice was consistent, be deemed to have been earned by the deceased before his death, we held that the testimony of officers to the effect that the payment was intended as a gift must prevail over respondent's argument.

In the light of the foregoing discussion, we hold that the payment of $13,012.50 received by Alice Ryder in 1950 was not taxable income to her and should not have been reported as such in her return for that year.

Pension Issue.

We have found as a fact that the payments to Alice by Standard pursuant to the agreement of February 17, 1949, and motion adopted by the board under date of July 5, 1949, both of which are set forth in our Findings of Fact, were distributions of profits. Accordingly, payments are taxable to, and includible in, Alice's income, and are not *deductible by Standard.*

Petitioner argues that the amount is deductible by Standard and not includible in Alice Ryder's income, relying mainly on Rev. Rul. 54-625, C.B. 1954-2, 85, and upon the cases therein cited on the deduction issue. While the facts stated in that ruling bear some resemblance to those before us, there are facts here present which we think controlling, and which lead to a contrary view. The facts which emerge in this case as the distinguishing features are that under the agreement it was necessary that the stock of her husband pass to Alice outright or in trust, either by her husband's will or by operation of law, and also that she retain the stock in order for her to receive the "pension." *We think the requirements that Alice must receive and retain her husband's stock are here controlling. Moreover, neither the agreement nor the resolution of the board recite that the payments were in recognition of her husband's past services.* The only recital of purpose relates to "restrictions upon the transfer of the shares." *Thus, the complexion of the payments is one of distribution of earnings to stockholders in order to deter alienation of stock, rather than to compensate for past services, even though measured thereby. In this respect, the importance to the family of control of the company is a factor of significance.*

The intention of the parties, as stated in the agreement, was to provide "certain restrictions on the transfer of the Shares." The parties promised that if the described

beneficiaries of the deceased officer would not transfer their shares, they would profit from the corporation's business beyond the regular dividends receivable from the ownership of the shares. Standard was not a party to the agreement, and its authorization of payment of the amounts called for in the agreement was procured by the controlling stockholders "pursuant to Article 3 of our Agreement executed by the stockholders of the Company," under which Alice Ryder was "entitled to a pension from the Company." *No such motive as compensation for her husband's past services is brought out in the record.*

Respondent argues that the case of Astorian-Budget Publishing Co., 44 B.T.A. 969 (1941), *is controlling, and we agree.* In that case an heir of a deceased stockholder, who inherited stock in the corporation, was paid certain amounts pursuant to an agreement among the stockholders to pay to his heir the salary of any stockholder who died so long as the stock was held by the heir. The agreement was among stockholders only and the corporation was not a party. We there held that no deduction for the payment was allowable to the corporation, which paid amounts to the heir of a deceased stockholder-signatory. As to the requirement that the heir hold the stock, we said (p. 973): "Such a provision bears more earmarks of a special provision for the distribution of profits to an officer-stockholder than it does to a pension payment." Petitioners attempt to distinguish the *Astorian-Budget* case on the grounds that the case dealt with an agreement which provided for payment to be made to the deceased stockholder's estate or next-of-kin, relying on *Est. of Edward Bausch et al.*, 14 T.C. 1433, affd. 186 F.2d 313 (C.A. 2, 1951). However, the Findings of Fact in *Astorian-Budget* recite that payment was to be made to the widow or next-of-kin, and payment was made directly to the next-of-kin of the deceased stockholder except during the period of administra-

tion of his estate. *We see no significant difference between the provisions of the contract in Astorian-Budget and the one involved herein which would in any way support petitioners' contention.* Furthermore, as pointed out in *Estate of Edward Bausch, supra*, the fact that payment was made to the estate is significant only as it tends to prove that the payment was not intended as a gift. Cf., *e. g., Estate of Frank J. Foote, supra.* In our case (as in some respects in *Astorian-Budget, supra*), other facts above adverted to—that the agreement required the intended recipient to receive and retain the stock; the absence of evidence that the payments were in compensation for past services; the fact that the corporation was not a party to the agreement and that the carrying out the provisions of the agreement was procured by the stockholders who wanted the stock to remain in the family—*negative any intention to make a gift, or pay a pension, and, to the contrary, tend to establish that the significant reason for the payments was to discourage the recipient from transferring her stock.*

Since we hold that the payments represented a distribution of profits by the company, they, of course, constituted income to Alice Ryder and are to be included as such in the year of receipt. Correspondingly, they are not deductible by Standard.

Issue re Additions to Tax.

With respect to the additions to tax determined for failure to file a declaration of estimated tax for the year 1950, petitioner has failed to carry her burden of proving error in respondent's determination. On brief, it is argued that petitioner was aged and "placed these affairs in the hands of Edwin J. Yentzer, a certified public accountant and a capable person to handle tax affairs." There is no evidence in the record (and petitioner's brief furnishes no reference to the transcript) to the effect that petitioner

was infirm in 1950, and did not pay attention to her affairs, or that she relied wholly or even substantially on Yentzer. Inconsistent with the inference which petitioner would have us draw from age alone, petitioner was elected to the board of directors of Standard in January of 1950, and from the minutes it appears that she took an active part in the affairs of the corporation.

It is also argued on behalf of Alice that there was disagreement with respect to the taxability of the payments, and that she would not have had to file a declaration of estimated tax if it were not for the inclusion of the payments in income. It is urged on this premise that her failure to file an estimated declaration was due to reasonable cause, and not to negligence. Petitioner, however, has not shown that her gross income from sources other than the payments in question could not reasonably be expected to be in excess of $600, and that her gross income from sources other than wages would not reasonably be expected to exceed $100 for the year in question. Section 58(a)(2) of the Internal Revenue Code of 1939. Her return for 1950 discloses income in excess of the minimum statutory requirements for filing a declaration of estimated tax. Moreover, there is no evidence that her failure to file a declaration of estimated tax was due to the fact that she thought the amounts here in question were not taxable. Indeed, for the year in question, a substantial portion of such payments were reported by her as income. We think it clear, therefore, that petitioner has failed to sustain her burden of proof on this issue.

Since her failure to file a declaration of estimated tax is deemed to be equivalent to an estimate of zero, the addition to tax under Section 294(d)(2) is applicable. The amounts of the additions must, of course, await the final computations under Rule 50.

Decisions will be entered under Rule 50.

EXHIBIT B.

United States Court of Appeals

FOR THE EIGHTH CIRCUIT.

No. 16,246

Standard Asbestos Manufacturing and Insulating Company, Inc., Petitioner, v. Commissioner of Internal Revenue, Respondent.	Petition to Review Decision of the Tax Court of the United States.

No. 16,247

George M. Ryder, Executor of the Estate of Alice D. Ryder, Deceased, Petitioner, v. Commissioner of Internal Revenue, Respondent.	Petition to Review Decision of the Tax Court of the United States.

[April 4, 1960.]

Before GARDNER, VOGEL, and VAN OOSTERHOUT, Circuit Judges.

GARDNER, Circuit Judge.

This matter is before us on petitions to review two decisions of the Tax Court, one redetermining deficiencies in the income taxes of petitioner Standard Asbestos Manufacturing and Insulating Company, Inc., for the years 1949, 1950, and 1951, and the other redetermining deficiencies in the income tax of Alice D. Ryder for the years 1950 and 1952.

Subsequent to the filing of the petition of Alice D. Ryder in this Court, she departed this life, whereupon, on the suggestion of her death, on motion, George M. Ryder, Executor of the Estate of Alice D. Ryder, was substituted as petitioner.

Petitioner Standard Asbestos Manufacturing and Insulating Company, Inc. is a Missouri corporation with offices in Kansas City, Missouri. It filed its federal income tax returns for the calendar years 1949, 1950, and 1951 with the Collector of Internal Revenue for the Sixth District of Missouri at Kansas City, Missouri.

The Commissioner of Internal Revenue determined that there were deficiencies in income taxes against petitioner Standard Asbestos Manufacturing and Insulating Company, Inc. for the calendar years 1949, 1950, and 1951, in the respective amounts of $19,644.67, $40,843.10, and $56,432.34. In due course petitioner Standard Asbestos Manufacturing and Insulating Company, Inc. filed with the Tax Court of the United States its petition appealing from the deficiencies determined by the Commissioner as aforesaid. On appeal, the Tax Court of the United States entered its decision that petitioner was liable for deficiencies in federal income taxes for the calendar years 1949, 1950, and 1951 in the respective amounts of $11,094.67, $28,799.31, and $39,662.60.

Petitioner Standard Asbestos Manufacturing and Insulating Company, Inc. was incorporated to do a general asbestos and insulating business and has developed into a technical specialties contractor organization handling all or part of the specifying, fabricating, manufacture, cost estimating, erection and surface finishing in connection with highly technical construction work involving insulating, air conditioning, and temperature control installations. At all times material hereto petitioner Standard Asbestos Manufacturing and Insulating Company, Inc. was on an accrual basis of accounting and petitioner's accounting period was the calendar year, and petitioner's books were kept on these bases.

From April 1, 1949 until the present Willard D. Ryder has served as the president of petitioner Standard Asbestos Manufacturing and Insulating Company, Inc., George M. Ryder as vice-president and treasurer, and Richard E. Ryder as secretary. The Ryders are brothers. The three performed the duties of the major officers of the corporation and estimated, bid, and supervised the work on contracts of over $5,000.00.

They originally joined the petitioner Standard Asbestos Manufacturing and Insulating Company, Inc. shortly after its organization in 1918 by their father, Willard E. Ryder. They served it continuously except for short intervals during employment by other firms, and the wages which each of the three Ryder brothers received during the 1920's and 1930's was small, below the standard for the industry, until about 1937.

Petitioner Standard Asbestos Manufacturing and Insulating Company, Inc. paid to each of the three Ryders for services rendered during the years 1949, 1950, and 1951, the sums of $52,232.14, $65,290.17, and $65,290.17,

respectively, and claimed same as business expenses in its income tax returns for the respective years. The Commissioner of Internal Revenue determined deficiencies for each of the three years in question, based upon the disallowance of compensations paid the three Ryders in excess of $35,000.00 each for 1949, $40,000.00 each for 1950, and $40,000.00 each for 1951. On appeal, the Tax Court determined that reasonable compensation for services rendered by each of the brothers was $42,500.00 for 1949, and $47,500.00 for each of the years 1950 and 1951, and that the compensations paid the Ryders in excess of these amounts in these years were unreasonable to the extent they were so in excess.

Alice D. Ryder, testatrix of petitioner George M. Ryder, Executor, was at all times pertinent to the issues herein a resident of Kansas City, Missouri. She filed her federal income tax returns for the calendar years 1950 and 1952 with the Collector of Internal Revenue for the Sixth District of Missouri, at Kansas City, Missouri.

The Commissioner of Internal Revenue determined that there were deficiencies in income taxes against her for the calendar years 1950 and 1952 in the respective amounts of $11,128.84 and $5,168.43, together with additions to tax under the Internal Revenue Code of 1939, Section 294 (d) (1) (A) of $1,444.66, and under Section 294 (d) (2) of $963.10, both for 1950, and duly notified her of such deficiencies on October 18, 1955. In due course she filed with the Tax Court of the United States her petition appealing from the deficiencies determined by the Commissioner as aforesaid. The appeal was consolidated with that filed by Standard Asbestos Manufacturing and Insulating Company, Inc., supra. Both appeals were decided on the pleadings and stipulations of facts, and evidence offered and accepted during the trial thereof, and

in due course the Tax Court of the United States entered its decision holding that she was liable for deficiencies in federal income taxes for the calendar years 1950 and 1952 in the respective amounts of $3,710.03 and $4,558.74, plus additions to tax for the 1950 calendar year under the Internal Revenue Code of 1939 of $776.95 as a penalty under Section 294 (d) (1) (A), and $517.97 as a penalty under Section 294 (d) (2).

Alice D. Ryder was 84 years old, and was the widow of Willard E. Ryder, the founder and president of Standard Asbestos Manufacturing and Insulating Company, Inc., from its organization in 1918 until his death April 1, 1949. Following Mr. Ryder's death, petitioner Standard Asbestos Manufacturing and Insulating Company, Inc. paid Mrs. Ryder a sum of money each year and denominated it a "pension". In the year 1950 Mrs. Ryder received $27,367.40 from Standard, and in 1952 she received $32,645.09 from Standard, pursuant to authorization by its Board of Directors.

The Tax Court determined that these payments to her by petitioner Standard Asbestos Manufacturing and Insulating Company, Inc., "constituted a distribution of profits and not a pension," and hence were taxable income to her and not deductible by petitioner Standard Asbestos Manufacturing and Insulating Company, Inc., as a business expense. The evidence will be further developed in the course of this opinion.

Petitioners, in seeking reversal, contend (1) the Tax Court erred in holding that none of the compensations paid by petitioner Standard Asbestos Manufacturing and Insulating Company, Inc., to Willard D. Ryder, George M. Ryder, and Richard E. Ryder for the years 1949, 1950 and 1951 was intended as compensation for services rendered in prior years; (2) the Tax Court erred in holding that

the compensations paid by Standard to Willard D. Ryder, George M. Ryder, and Richard E. Ryder, for the services rendered by each of them for the year 1949, were unreasonable to the extent that they were in excess of $42,500.00 for each of them, and the Tax Court erred in holding that the compensations paid to them for the services rendered by each of them for the years 1950 and 1951, respectively, were unreasonable to the extent they were in excess of $47,500.00 for each of them for each of said years; (3) the Court erred in holding that amounts accrued and paid by Standard in 1949, 1950, and 1951, in the sums of $20,491.08, $32,645.08, and $32,645.09, respectively, to Mrs. Ryder were not deductible by Standard in any part as a pension; (4) The Tax Court erred in holding that the amounts received by Mrs. Ryder from Standard in 1950 and 1952, in the sums of $27,367.40 and $32,645.09, respectively, were distributions of profit and were includible in Mrs. Ryder's taxable income; and (5) the Tax Court erred in holding that Mrs. Ryder failed to meet the burden of proving reasonable cause for failure to file declaration of estimated tax for 1950, and erred in holding that additions to tax were applicable under the Internal Revenue Code of 1939, Sections 294 (d) (1) (A) and 294 (d) (2).

It is contended by petitioner Standard Asbestos Manufacturing and Insulating Company, Inc., that part of the salaries paid the Ryder brothers for the years 1949, 1950, and 1951 was to compensate them for services rendered in prior years. It is conceded by the Commissioner that the compensation paid these officers for a number of years prior to 1937 was comparatively low, but on December 20, 1937, the Board of Directors specifically took action to pay additional compensation for the years 1928 to 1930 in an amount equal to 40% of the salaries actually paid. The minutes show that the purpose of this payment was to

make good for the low salaries paid the recipients from 1928 to 1930.

Again, at a meeting of the Directors on January 6, 1941, salaries of the Ryder brothers were raised to $11,000.00 because of the low salaries paid the executive officers prior to 1937, and on January 5, 1942, the Board of Directors, again reciting that low salaries had been accepted by the Ryder brothers during the years prior to 1937, again raised their salaries, this time to $20,000.00.

Conceding that the salaries from 1927 to 1937 were inadequate, the record clearly indicates that the corporation made corrections therefor prior to the taxable years. It is significant that the minutes of the company authorizing the salaries for the taxable years here in controversy, unlike prior minutes, make no reference to the low payment in earlier years, but instead were based upon the increase in the volume of business. The minutes of the meeting reflect the following:

> "A motion was presented by G. M. Ryder, as follows:
>
> In consideration of the constantly increasing volume of business being handled by the Company and recognizing the resultant increase in responsibility levied upon the officers, multiplying the demands upon their time, their energies, etc., it is directed that compensation to officers and key personnel be authorized and approved up to, but not to exceed, the following annual amounts:
>
> | | |
> |---|---|
> | W. D. Ryder, Acting President | $67,500.00 |
> | R. E. Ryder, Secretary | $67,500.00 |
> | G. M. Ryder, Treasurer | $67,500.00 * * *." |

Referring to a somewhat similar situation presented to us in *Builders Steel Co.* v. *Commissioner of Internal Revenue*, 8 Cir., 197 F.2d 262, we said:

> "The bonuses given at the end of the year, according to the minutes of the petitioner, were based to a large extent at least upon the earnings that the company had made during the year and its consequent ability to pay. In addition to the fact that there were large earnings resulting to a greater or lesser extent from the efforts of these officers and employees, we cannot escape the thought that the distribution of earnings of the company had the effect of very substantially reducing the excess profit taxes collectible against the petitioner."

There was no evidence that any portion of the salaries paid for the years in question was intended as payment for services rendered in prior years and it must be borne in mind that petitioner Standard Asbestos Manufacturing and Insulating Company, Inc., at the time these salaries were fixed, was a closed corporation and petitioner's officers were the owners of substantially all the stock. This presented a fact question for the determination of the Tax Court and its finding is presumptively correct and should not be set aside unless clearly erroneous. *Builders Steel Co.* v. *Commissioner of Internal Revenue*, *supra*; *Twin City Tile & Marble Co.* v. *Commissioner of Internal Revenue*, 8 Cir., 32 F.2d 229; *Heil Beauty Supplies, Inc.*, v. *Commissioner of Internal Revenue*, 8 Cir., 199 F.2d 193. *The burden of proof on this issue was on the petitioner. It produced no persuasive evidence that the salaries were enhanced to compensate for services for prior years, and the circumstantial evidence, in our opinion, constituted substantial evidence and warranted the finding assailed.*

As to the contention that petitioner Standard Asbestos Manufacturing and Insulating Company, Inc., was entitled to deduct the full amount paid the Ryder brothers as salaries, it remains to consider the argument that the salaries were in any event reasonable. It is to be noted

that while the salaries here contested represented a very high percentage of net income in the taxable years, the salaries of other officers remained relatively unchanged. No other officer received more than $9,000.00 during the years in question. The reasonableness of these salaries presented a question of fact. *Builders Steel Co.* v. *Commissioner of Internal Revenue, supra; Heil Beauty Supples, Inc.*, v. *Commissioner of Internal Revenue, supra; Gen Jewelry Co.* v. *Commissioner of Internal Revenue*, 5 Cir., 165 F.2d 991; *Wright-Bernet* v. *Commissioner of Internal Revenue*, 6 Cir., 172 F.2d 343; *Miles-Conley Co.* v. *Commissioner of Internal Revenue*, 4 Cir., 173 F.2d 958. In *Builders Steel Co.* v. *Commissioner of Internal Revenue, supra*, we said:

> "The only issue presented is whether the salaries paid by petitioner to its president, vice-president, secretary-treasurer and one J. H. Collopy for services rendered in each of the calendar years involved were unreasonable and excessive and hence not deductible under Section 23 (a) of the Internal Revenue Code. * * * As already observed the only question before us at this time is whether this finding of the Tax Court is sustained by substantial evidence or whether it is clearly erroneous. The finding involved a pure question of fact."

Likewise, in *Heil Beauty Supplies, Inc.*, v. *Commissioner of Internal Revenue, supra*, in considering a finding of the Tax Court as to the reasonableness of salaries, we said:

> "Any payment arrangement between a corporation and a stockholder—and particularly a major stockholder, with his normal power of control—is always subject to close scrutiny for income tax purposes, so that deduction will not be made, as purported salary, rental or the like, of that which is in the realities of the situation an actual distribution of profits. 4 Mer-

tens Law of Federal Income Taxation, §25.46, pp. 399, 400. And we have previously held that whether or to what extent payments made by a corporation to a stockholder represent compensation for services or constitute a distribution of profits is essentially the determination of 'a matter purely of fact.'"

In support of the reasonableness of the officers' salaries petitioner Standard Asbestos Manufacturing and Insulating Company, Inc., offered the testimony of Mr. John Dragisic, an executive officer of the Asbestos and Magnesia Materials Company, a competitor of petitioner, that in his opinion the salaries here contested were reasonable and he compared these salaries with various salaries paid officers of his own company in support of his opinion. The Commissioner, on the other hand, offered the testimony of one Mr. David E. Kelley. This witness, also president of a competing company, testified that during the years in question he received a salary of between $15,000.00 and $16,000.00 in 1949, and between $25,000.00 and $26,000.00 in 1950 and 1951. His experience and ability were comparable to that of taxpayer's officers and his scope of activity and hours of work were comparable. It is to be noted that, during the years in question, taxpayer Standard Asbestos Manufacturing and Insulating Company, Inc., paid only $5,000.00 a year in dividends, whereas the company represented by Mr. Dragisic paid dividends of $50,000.00 in each of the taxable years. *At most, the testimony presented a conflict to be determined by the Tax Court and that Court has resolved the conflict, if it can be called such, against the taxpayer. The Court fixed the salaries for the years in question at $42,500.00 for the year 1949, and $47,500.00 for 1950 and 1951, for each of the Ryder brothers, and we think the finding in this regard is sustained by substantial evidence. Other contentions in support of the Tax Court's decision as to the reasonable-*

ness of these salaries are urged but we find it unnecessary, in view of what we have already held, to give them further consideration.

Taxpayer Standard Asbestos Manufacturing and Insulating Company, Inc., paid Alice D. Ryder, widow of Willard E. Ryder, deceased, $20,491.08 in 1949, $32,645.08 in 1950, and $32,645.09 in 1951, designating it as "pension" and deducted said amounts from taxable income. The Commissioner disallowed the deductions and the Tax Court sustained the ruling of the Commissioner in this regard.

Alice D. Ryder's husband, for a number of years prior to his death, was a substantial stockholder and the president of Standard Asbestos Manufacturing and Insulating Company, Inc. Shortly before the death of Willard E. Ryder, on February 17, 1949, the Ryder family, owning 473½ of the 500 shares of Standard Asbestos Manufacturing and Insulating Company, Inc., signed an agreement which reads as follows:

> "THIS AGREEMENT, made and entered into this 17th day of February, 1949, by and between W. E. Ryder, Alice D. Ryder, Willard D. Ryder, Merle H. Ryder, George M. Ryder, Iris B. Ryder, Richard E. Ryder, Hazel M. Ryder and E. McElreath (hereinafter sometimes separately referred to as a 'stockholder' and collectively referred to as the 'Stockholders'),
>
> "WITNESSETH:
>
> "WHEREAS, The Stockholders presently or prospectively own substantially all of the common capital stock (hereinafter referred to as the 'Shares') of Standard Asbestos Manufacturing and Insulating Co., a Missouri corporation (hereinafter referred to as the 'Company'), and
>
> "WHEREAS, the Stockholders have agreed among themselves with respect to certain restrictions upon the transfer of the Shares, and desire to reduce said agreement to writing

"NOW THEREFORE, in consideration of the premises, the mutual covenants herein contained, and the mutual benefits to be derived herefrom, the sufficiency of such consideration being hereby acknowledged, it is understood and agreed between the parties as follows:

* * * * * * *

ARTICLE II.

"The surviving Stockholders, pro rata, are hereby given the irrevocable right and option to purchase the shares of a deceased Stockholder within a period of ninety days following the death of such Stockholder unless he shall have provided by his or her Last Will and Testament for the ultimate transfer of such Shares to his or her spouse or lineal descendants. Such option shall be exercised and the purchase price determined and paid in all respects in the manner set forth in Article I hereof.

ARTICLE III.

"If W. E. Ryder, Willard D. Ryder, George M. Ryder, or Richard E. Ryder shall leave all of his Shares to or for the benefit of his widow in his Last Will and Testament, either outright or in trust for her life, or if all of such Shares shall descend to such widow by operation of law, the Stockholders will cause the Company to pay a pension to such widow so long as she retains all of such Shares (or such trust continues and the trustee retains all of such Shares) and she does not remarry. Such pension shall be paid quarterly, and shall be the equivalent of 50% of the average of the salaries paid by the Company during the preceding quarter to W. E. Ryder and his lineal descendants."

The Tax Court, after reviewing the entire record in the present case, found that the payments made to Alice D. Ryder were made pursuant to this agreement, not as a

pension, but rather to deter a widow of any of the Ryder family from selling her corporate stock and consequently to maintain family control over the corporation.

It is, however, argued that the payments made to Alice D. Ryder were in recognition of services of her deceased husband. It is to be noted that the agreement makes no reference to payments in recognition of past services of Mrs. Ryder's husband but the agreement authorizes payment in order to restrict the transfer of shares and retain family control of the corporation. It is significant, too, that the motion authorizing payment to Alice D. Ryder, makes no mention of recognition of past services of her husband. On the other hand, Mrs. Ryder maintained that she received the payments as gratuities.

What is said by the Tax Court in *Astorian-Budget Publishing Co.* v. *Commissioner*, 44 B. T. A. 969, and *Union Packing Co.* v. *Commissioner*, 1955 P-H T. C. Memorandum Decisions, par. 55,308, is here apposite. In *Astorian-Budget Publishing Co.* v. *Commissioner, supra,* it is said:

> "However, the only limitation of time on the payment is the period that Dorothy Engle continues to hold the stock. Such a provision bears more earmarks of a special provision for the distribution of profits to an officer-stockholder than it does of a pension payment."

And in *Union Packing Co.* v. *Commissioner, supra*, it is said:

> "Payments were made only so long as the widow held the stock. Hazel Skivel performed no services and was not entitled to a salary. She received no distribution from the corporation except in this form and received this money by virtue of her stockholdings and as a dividend."

This presented a question of fact for the determination of the Tax Court. Manifestly, if payment to the recipient is for the purpose of assuring control over the stock, then this payment does not constitute a deductible business expense. *Warren Steam Pump Co.* v. *Commissioner*, 13 B. T. A. 721. *We are persuaded that the conclusion of the Tax Court that the payments to Mrs. Ryder "represented a distribution of profits by the company" is sustained by the record and is not clearly erroneous.*

Alice D. Ryder failed to file declaration of estimated tax for the year 1950 and the Commissioner added a penalty pursuant to Section 294 (d) (1) (A), Internal Revenue Code of 1939. This action of the Commissioner was sustained by the Tax Court and this ruling is urged as erroneous. The penalty having been imposed, the burden was on Mrs. Ryder to prove that her failure to file such an estimate was "due to reasonable cause and not to willful neglect." Section 294 (d) (1) (A), Internal Revenue Code of 1939; *Southeastern Finance Co.* v. *Commissioner of Internal Revenue*, 5 Cir., 153 F.2d 205.

It was argued before the Tax Court and the argument is here renewed that her failure to file the estimate of the tax for 1950 was due to the fact that she relied upon Edwin J. Yentzer, her accountant, and it is also urged that she was inactive because of her advanced age and ill health. In passing it may be observed that she apparently filed such return in 1949 and 1951 and, as pointed out by the Tax Court, she produced no evidence that she relied on her accountant nor did she produce any evidence that she was in ill health or inactive, but on the other hand she was one of the directors of the corporation and according to the record attended all its meetings. *The finding of the Tax Court on this issue is presumptively correct and there is no basis in the record for holding that it is clearly erroneous.*

In addition to imposing a penalty on taxpayer, Alice D. Ryder, for failure to file an estimate for the year 1950, the Commissioner imposed a penalty for substantial underestimation of her tax for that year. *Not having filed an estimate, it cannot logically be contended that she substantially underestimated her tax. Commissioner of Internal Revenue v. Acker*, 361 U.S. 87. *Counsel for the Commissioner, in his brief, concedes that the imposition of this additional tax constituted error and we so hold.*

That portion of the Tax Court's decision imposing a penalty for substantial underestimation of the tax of Alice D. Ryder for 1950 is therefore reversed, and as so modified, the decision is affirmed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

EXHIBIT C.

United States Court of Appeals

FOR THE EIGHTH CIRCUIT.

STANDARD ASBESTOS MANUFACTURING AND INSULATING COMPANY, INC.,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.
No. 16,246.

ALICE D. RYDER,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE
Respondent.
No. 16,247.

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES.

PETITION FOR REHEARING ON BEHALF OF PETITIONERS.

Come now Standard Asbestos Manufacturing and Insulating Company, Inc., and George M. Ryder, Executor of the Estate of Alice D. Ryder, Deceased, Petitioners herein, and within the time allowed by law and Rule 15 of this Honorable Court, and file this, their Petition for Rehearing for the purpose of calling to the attention of the Court controlling matters of law and fact which the Court overlooked in deciding the case as follows:

1. In ruling (Opinion p. 8) that the issue of whether any portion of the salaries paid W. D. Ryder, R. E. Ryder and G. M. Ryder (Opinion p. 7) for the years in question (1949, 1950, 1951) were intended as payment for services rendered in prior years "presented a question of fact for the determination of the Tax Court and its finding is presumptively correct and should not be set aside unless clearly erroneous" the court ruled the case under a mistake of law since whether such salaries were intended as payment for services rendered in prior years is a legal inference from the evidentiary facts, "a conclusion of law or at least a determination of a mixed question of law and fact." "It is subject to judicial review, and on such review, the court may substitute its judgment for that of the Board" and the Court is not bound by the "clearly erroneous" rule. *Bogardus* v. *Commissioner of Internal Revenue*, 302 U.S. 34, 38-39, 58 S. Ct. 61, 64; *Helvering* v. *Tex-Penn Oil Co.*, 300 U.S. 481, 491, 57 S. Ct. 569, 574; *Bounds* v. *United States*, 4 Cir., 262 F.2d 876, 880 (1); *Evans* v. *Commissioner of Internal Revenue*, 9 Cir., 264 F.2d 502, 514 (7); *Weible* v. *United States*, 9 Cir., 244 F.2d 158, 161.

2. The ruling of this Court referred to under paragraph No. 1 above declining to give Petitioners the full review on appeal to which they are entitled is based on misinterpretation and misapplication of the Supreme Court decisions and decisions of other Courts of Appeal of the United States and is clearly erroneous as a matter of law. *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 387, 68 S. Ct. 525, 538; *Commissioner of Internal Revenue* v. *Wilcox*, 327 U.S. 404, 410, 66 S. Ct. 546, 550; *Consolidated Naval Stores Co.* v. *Fans*, 5 Cir., 227 F.2d 923, 925 (1); *Neil* v. *Commissioner of Internal Revenue*, 5 Cir., 269 F.2d 563, 567-568.

3. The opinion herein (Opinion pp. 8, 10, 11, 14, 15) judicially formalizes the ultimate, but nevertheless administrative conclusions of the Tax Court contrary to and in conflict with the following decisions of other United States Courts of Appeals. Holding such questions to be issue of law or issues of mixed law and fact as to which these appellants are entitled to full judicial review, free from the "clearly erroneous" rule and with the right to review and disagree with the findings of the Tax Court; and substitute its own judgment. *Ortmayer* v. *C. I. R.*, 7 Cir., 265 F.2d 848, 854; *Bounds* v. *United States*, 4 Cir., 262 F.2d 876, 880 (1); *Weible* v. *United States*, 9 Cir., 244 F.2d 156, 161 (1); *Thornley* v. *Commissioner of Internal Revenue*, 3 Cir., 147 F.2d 416, 420 (4); *Towner* v. *Commissioner of Internal Revenue*, 2 Cir., 182 F.2d 903, 905 (2).

4. In ruling the resolution of the Board of Directors for the years in question (Opinion pp. 7-9) without recognizing and giving effect to the presumption this resolution of the Board of Directors granting such compensation created the presumption that the allowances were reasonable and proper, the opinion herein is based on an erroneous view of the law. *Commissioner of Internal Revenue* v. *Heininger*, 320 U.S. 467, 475, 64 S. Ct. 249, 254; *Indiatlantic, Inc.*, v. *Commissioner of Internal Revenue*, 6 Cir., 216 F.2d 203, 305; *Maytag* v. *Commissioner of Internal Revenue*, 10 Cir., 187 F.2d 962, 964 (2); *Helvering* v. *Smith*, 4 Cir., 132 F.2d 965, 968 (6); *Mayson Mfg. Co.* v. *Commissioner of Internal Revenue*, 6 Cir., 178 F.2d 115, 119 (2).

5. The Court erred as a matter of law in holding the minutes of the corporation for the years in question (Opinion pp. 7, 8) were conclusive against Petitioners because not reciting that part of the compensation was for past years since the gradual reimbursement for past lean years had been set up as a program in past years and had be-

come automatic in later years under favorable business conditions which yielded materially higher compensation, making such belated payments possible. *Mayson Mfg. Co.*, 6 Cir., 178 F.2d 115, 120 (6, 7).

6. In ruling that the issue of whether the sums paid Alice D. Ryder, widow of Willard E. Ryder, for the years in question, 1949, 1950, and 1951, were dividends of gratuities (Opinion pp. 11, 13, 14) and whether allowable as deductions to petitioner Standard Asbestos Manufacturing and Insulating Company, Inc., and whether exempt to the estate of Alice D. Ryder, deceased, as gifts were questions of fact only and to be reversed only when "clearly erroneous" and not issues of law, or issues of mixed law and fact as to which it was the duty of this Court to afford a full judicial review and feel free to substitute its own judgment for that of the Board, if justified by the facts, this Court erred and brought the opinion herein into conflict with the decisions of the Supreme Court of the United States and the decisions of other circuits as shown by the decisions cited under paragraph numbered 1 of this petition. The decision is also in conflict with a later decision nearer in point on the facts involved, so far as the widow's estate is concerned, to-wit: *Bounds* v. *United States*, 4 Cir., 262 F.2d 873, 880, reviewing many decisions and holding a similar payment to a widow a gratuity, and free from income tax.

7. In holding that the payment to said widow was a distribution of profits, this Court overlooked the fact that the amount paid the widow in the years in question was entirely out of proportion to and inconsistent with the allowance of only $5,000.00 per year total dividends (Opinion pp. 10, 11). It was likewise inconsistent with the clearly evident donative intention of the employer company and in conflict with the decision of *Rounds* v. *United States*, 4 Cir., 262 F.2d 876, holding payments to a widow under

similar circumstances a gratuity and free from income tax; that such ruling was a question of law or mixed law and fact and that the Court was not bound by the "clearly erroneous" rule but was free to substitute its judgment for that of the Tax Court.

8. Even under the "clearly erroneous" rule (which we deny is applicable here) the judgment of the Tax Court should be reversed as to both cases here involved. See decisions under numbered paragraph 1 and the case of *Bounds* v. *United States*, 4 Cir., 262 F.2d 876.

9. Numbered paragraphs 2 and 3 above in this petition are equally applicable to the Court's ruling on the payments to the widow, both as to the right of the corporation and said widow to be free from income taxes on such sums.

For each and all of the controlling matters of law and fact which Petitioners claim have been overlooked by the Court in deciding the cases and to which the attention of the Court is hereinabove respectfully directed, Petitioners pray the Court to grant them rehearings in each and both of these cases.

Because the question involved is one of importance affecting substantial property rights of Petitioners, it is further respectfully prayed that if there is doubt in the mind of the Court, that these cases be transferred to a consideration of the Court, *en Banc*, pursuant to Rule 15 of this Honorable Court.

Respectfully submitted.

HARRY H. ELLIS,
920 Argyle Building,
Kansas City, Missouri.
KENNETH C. WEST,
and
WALTER A. RAYMOND,
1313 Home Savings Building,
Kansas City, Missouri,
Attorneys for Petitioners.

CERTIFICATE OF COUNSEL.

The undersigned, Harry H. Ellis, counsel of record for the Petitioners, Standard Asbestos Manufacturing and Insulating Company, Inc., and George M. Ryder, Executor of the Estate of Alice D. Ryder, Deceased, hereby certifies that the above and foregoing Petition for Rehearing is submitted in good faith and is believed to be meritorious.

HARRY H. ELLIS.

EXHIBIT D.

UNITED STATES DISTRICT COURT.
FOR THE EIGHTH CIRCUIT.

September Term, 1959.

Standard Asbestos Manufacturing and Insulating Company, Inc., Petitioner, vs. Commissioner of Internal Revenue. No. 16246.	On Petition for Review of the Decision of the Tax Court of the United States.
Alice D. Ryder, Petitioner, vs. Commissioner of Internal Revenue. No. 16247	On Petition for Review of the Decision of the Tax Court of the United States.

Petition for rehearing previously filed on behalf of petitioners in the instant causes has been considered by the Court, and it is now here ordered that the said petition be, and it is hereby denied. The alternative request for rehearing *en banc* is also denied.

April 29, 1960.

EXHIBIT E.

(Judgment in Cause No. 16246.)

United States Court of Appeals

FOR THE EIGHTH CIRCUIT.

No. 16246 - - - - September Term, 1959.

Standard Asbestos Manufacturing and Insulating Company, Inc., Petitioner,

vs.

Commissioner of Internal Revenue.

On Petition for Review of Decision of The Tax Court of the United States.

This cause came on to be heard on the Petition to Review the Decision of The Tax Court of the United States entered September 9th, 1958, determining that there are deficiencies in the income taxes of the petitioner for the years 1949, 1950 and 1951, respectively, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the decision of The said Tax Court in this cause be, and the same is hereby, affirmed.

And it is further Ordered by this Court that the Petition for Review in this cause be, and it is hereby, dismissed.

April 4th, 1960.

EXHIBIT F.

(Judgment in Cause No. 16247.)

United States Court of Appeals

FOR THE EIGHTH CIRCUIT.

No. 16247 - - - - September Term, 1959.

George M. Ryder, Executor of the Estate of Alice D. Ryder, Deceased, Petitioner,

vs.

Commissioner of Internal Revenue.

On Petition for Review of Decision of The Tax Court of the United States.

This cause came on to be heard on the Petition to Review the Decision of The Tax Court of the United States entered September 9, 1958, determining that there are deficiencies in the income tax and additions to the tax of the petitioner Alice D. Ryder in The Tax Court of the United States for the years 1950 and 1952, respectively, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that that portion of the decision of The Tax Court imposing a penalty for substantial underestimation of the tax of Alice D. Ryder for 1950 be, and is hereby reversed, and as so modified, the decision of said Tax Court is affirmed.

And it is further Ordered by this Court that this cause be, and it is hereby remanded to the said Tax Court for proceedings not inconsistent with the opinion this day filed.

April 4th, 1950.